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November 17, 2000

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BY HAND

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
Case Control Unit
Attn: STB Ex Parte No. 582 (Sub-No.1)
1925 K Street, N.W.
Washington, DC 20423-0001

Re: Major Rail Consolidation Procedures (STB Ex Parte No. 582 (Sub-No. 1))

Dear Mr. Williams:

Enclosed for filing in the above-referenced proceeding are an original and 25 copies of the Comments of Canadian National Railway Company (including the attached Statement of Professor Bernard S. Black), submitted in response to the Board's Notice of Proposed Rulemaking (served October 3, 2000). All pages of this filing, including this cover letter, are paginated consecutively, as required by the NOPR (slip op. at 38).

Also enclosed is a diskette containing the text of this filing in WordPerfect 6/7/8/9 format.

Very truly yours,

Paul A. Cunningham

Paul A. Cunningham

Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF CANADIAN NATIONAL RAILWAY COMPANY

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BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES
COMMENTS OF CANADIAN NATIONAL RAILWAY COMPANY

TABLE OF CONTENTS

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES
COMMENTS OF CANADIAN NATIONAL RAILWAY COMPANY

Canadian National Railway Company, Grand Trunk Western Railroad Incorporated, and Illinois Central Railroad Company (collectively, "CN") hereby file comments in response to the Board's Notice of Proposed Rulemaking, Major Rail Consolidation Procedures, served October 3, 2000 ("NOPR").[1]

In this rulemaking the Board is seeking to draw lessons from recent experience and to take into account future prospects in the railroad industry. These efforts are well directed. In both this rulemaking and in individual merger proceedings, the Board should draw lessons from recent experience and take cognizance of current circumstances. The Board has avowedly designed these rules to raise the bar to assure that future mergers are consistent with the public interest. CN agrees that the Board should do so.

For this regulatory initiative to accomplish its goal, the raised bar must be clearly in sight and no higher than necessary, and it must be the same for everyone. The merger rules should, in proper furtherance of the Act, avoid unnecessary or open-ended regulation; continue to facilitate private initiative; further the public interest in trade and investment flows as envisaged by Congress when it approved NAFTA[2]; and avoid advantaging one group of railroads over another.

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[1]In these comments CN uses the abbreviations and short-form citations listed in Appendices A and B in the NOPR.

[2]North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 289 (chs. 1-9); 32 I.L.M. 605 (chs. 10-22), *available at* http://www.nafta-sec-alena.org/english/ index.htm. NAFTA was approved by both Houses of Congress in the North American Free Trade
(continued...)

From this perspective, there is much to support but also much to question in the Board's proposal. In these comments, CN examines certain aspects of the Board's proposals of greatest concern to CN, noting especially where the proposed regulations would make the hurdle unclear, or unnecessarily high, or unreasonably discriminatory.

It is CN's position that the Board can reasonably require applicants to (1) satisfy new req[illegible] for detailed market analyses (subject to the availability of data); (2) present a d[illegible] level review" showing how operational changes will translate into benefits for shippers ([illegible]hich in turn increase competition as other rail carriers and other modes respond); (3) provide a Service Assurance Plan; (4) provide a Safety Integration Plan; (5) provide more analysis of geographic and product competition; (6) provide more analysis of the post-merger competitive position of Class II and III railroads; and, (7), through "full-system" plans, show that activities in foreign countries will not have adverse operating impacts in the U.S. While there is always the possibility that particular disagreements may emerge in the application of these requirements, CN agrees with these proposals in principle and in most of the particulars.

It would not, however, be reasonable for the Board to require applicants (1) not only to preserve but to "enhance" competition through conditions; (2) to anticipate downstream transactions and evaluate them under the public interest standard; (3) to anticipate whether the Board would deny approval of a voting trust under a public interest test even if the trust properly insulates from unauthorized control; (4) to impose additional requirements for the prima facie case of applicants in transnational mergers, or (5) to increase complexity and reduce the likelihood of settlements so that merger proceedings will inevitably require the maximum statutory period. Nor would it be reasonable for the Board to change its proven approach to three-to-two reductions (if in fact that is the Board's intent in the proposal).

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[2](...continued)
Agreement Implementation Act, Pub. L. No. 103-182, § 101(a)(1), 107 Stat. 2057, 2061 (1993), pursuant to sections 1101-1103 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. §§ 2901-2903.

I. INTRODUCTION AND OVERVIEW

Prior to this rulemaking, and proceeding on a case-by-case basis within broad guidelines, the ICC and then the Board had developed approaches to major mergers that generally worked well. As CN, AAR, and others discussed in their ANPR comments, the history of freight railroads since the Staggers Act is a success story, and mergers have unquestionably contributed to that success.[3] In furtherance of the deregulatory mandate of the Staggers Act, the ICC and then the Board developed merger policy in light of business and economic concepts – competition, service, and efficiency – and not artificial regulatory constructs. Railroads contemplating multi-billion dollar transactions were able to value such transactions and reasonably assess and assign costs to likely regulatory outcomes. The ability to make these judgments within reasonable limits proved important in developing an efficient market for control, in which economic rather than regulatory calculations were the primary drivers of structural change. And there never was the slightest hint of bias against "transnational" transactions in the agency's general policies or dispositions in particular cases.

To an important extent, this degree of predictability was the result of doctrines that put logical boundaries on the regulatory costs that merger applicants would have to pay in order to enable the agency to find that a transaction was consistent with the public interest. Most important, the agency would impose conditions only as a direct offset to demonstrable public harms – primarily reductions in competition – that would be caused by a merger, and then only proportionally, to the extent necessary to offset the harm. If, for example, a merger would deprive shippers of a build-out opportunity, the offsetting condition was not direct access to another railroad, which would leave the shipper better off than before the merger. Instead, the

[3]*See* Comments of CN, at 7-9 (filed May 16, 2000), *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1) ("CN ANPR Comments"); Reply Comments of CN (filed June 5, 2000), *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1) ("CN ANPR Reply Comments"); Comments of the Association of American Railroads, at 2-6 (filed May 16, 2000), *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1). CN incorporates by reference all of the CN ANPR Comments and CN ANPR Reply Comments.

condition would be tailored to preserve the build-out opportunity, for example, through trackage rights to the point of build-out.[4] The administration of the conditioning powers by the ICC and the Board made clear that this was not an open-ended authority.

Elements in the Board's proposed "paradigm shift," by conferring massive discretion on the Board, would depart from the fundamental deregulatory tenets of the Act, and would impair the predictability that is essential to the continued evolution through private initiatives of efficient structures for North American railroads. As discussed below, these elements of the proposal would unnecessarily substitute regulatory requirements for the market. And the boundaries of these open-ended requirements could not reasonably be predicted – and, in the end, applied – through appropriate legal or economic reasoning.

While nominally leaving mergers to private initiatives, the Board would in fact greatly increase regulatory risk and the role of regulatory calculations in place of market calculations. The Board would assume the authority to reject proposals that did not fit with its preferred conception of an overall end-structure, and maximize rather than minimize federal regulatory controls under a statute whose purpose is the opposite.

The group of proposals that CN supports, if reasonably applied, would appropriately heighten the Board's scrutiny of the effects of merger on competition, efficiency, and service. These requirements would test the applicants' own reasons for proposing a merger or use of a voting trust. The group of requirements that CN opposes is very different. They would go beyond preserving competition or ensuring that applicants' own expectations of increased efficiency and improved service are solidly based. These requirements would assume that (1) even solidly based private initiatives designed to increase competition and improve service and

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[4] *See, e.g. BN/SF*, Decision No. 38, slip op. at 68 (ICC served Aug. 23, 1995) (shipper with pre-merger build-out option entitled only to preservation of the option and not to direct access by another railroad; direct access would permit the shipper to "obtain the benefits of a second carrier . . . minus the trouble and expense of building out . . . conditioning power is used to *preserve* competitive options (not to *expand* them)") (emphasis in original); *accord*, *UP/SP*, Decision No. 58, slip op. at 3 (STB served Nov. 20, 1996).

efficiency are not consistent with the public interest; (2) the natural procompetitive market outcomes of a well-designed and solidly supported merger may still be legally insufficient in light of anticipated future mergers; and (3) in any event, these market outcomes will always require supplementation through conditions to enhance competition to some unspecified extent.

Each of the group of proposed requirements that CN opposes would carry an unfortunate common denominator: tremendous administrative discretion and corresponding uncertainties in the private sector. The discretion and uncertainties relate to what evidence the Board would deem sufficient to establish a prima facie case, the nature and extent of conditions the Board might deem sufficient to enhance competition, the Board's approach to three-to-two reductions, how the Board would evaluate downstream transactions, how the Board would evaluate transnational transactions, what would constitute the public interest with respect to a voting trust, and how long it all would take.

The uncertainties would arise not simply because the proposed requirements are new. The uncertainties are inherent in the nature of the requirements themselves. The introduction of these uncertainties into the market for control would therefore be dysfunctional. As already noted, evaluation of possible transactions would become much more difficult for managements and investors. The degree of regulatory risk, the extent and cost of possible conditions, and the timing of a final Board decision would become much more uncertain. The consequence could be to deter mergers that would have yielded substantial net public benefits.

Where parties do nevertheless propose major mergers, the open-ended requirements and uncertainties would make it more difficult for parties to assess their bargaining strength in settlement negotiations, and would encourage more opportunism among merger opponents. The reduced likelihood of settlements would poorly serve the goals of the Act, heretofore shared by the Board, to encourage structural changes through private initiatives.

More fundamentally, the uncertainties increase the risk of regulatory miscalculation by parties who decide to seek Board approval for a major transaction. The Board might impose conditions to enhance competition that the parties find unacceptable. It might make determinations based on hypothetical downstream transactions that result in disapproval or unacceptable conditions. The Board might find negatives in the transnational character of the transaction that the parties had no reason to anticipate, again resulting in disapproval or unacceptable conditions.

The failure of parties to consummate a proposed transaction, whether because the Board denies approval or because it imposes unacceptable conditions, can entail large wasted public and private costs. Direct dollar outlays by parties proposing and opposing an application are substantial. The announcement of a merger can depress the applicants' stock prices for the pendency of the proceeding. In addition, any major merger proposal entails substantial opportunity costs. The applicants forego other possible mergers and perhaps other strategic initiatives. Investments in facilities and equipment that would be economic for a stand-alone railroad may be deferred because they would not be undertaken, or would be done differently, as a merged railroad. There can be an attrition of senior management. In the exercise of their own business judgments, the applicants may be less willing to enter into long-term contracts with shippers. In short, the failure of parties to consummate after a Board proceeding is costly business, for both applicants and shippers.[5] Uncertainty magnifies that risk, which the Board should seek to minimize wherever possible.

Finally, the uncertainty can only prolong merger proceedings. The Board, however, has enough familiarity with the rail system and enough experience with mergers that it should now seek to structure its regulations whenever possible to expedite merger proceedings. CN believes

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[5]The *SF/SP* merger is the only example since the Staggers Act of a fundamental regulatory miscalculation by applicants to a major merger. That episode illustrates the public and private costs of such fundamental miscalculation. The proceeding took nearly three years. After the denial, SP languished in a voting trust for five years. Without strategic direction, SP's willingness and ability to make essential investments declined. The results came to full light only after implementation of the merger with UP, to the great detriment of shippers and others. The Board can raise the bar for future major mergers without unnecessarily increasing the risk of this type of unfortunate regulatory outcome.

that applicants in major mergers should ordinarily be able to obtain a Board decision within a year after filing their notice of intent. Thus, if applicants file their application after the minimum three-month period following their notice of intent, the Board should be able to complete the evidentiary phase and issue a decision within nine months thereafter. The proposals that CN opposes would be an unnecessary move in the opposite direction, virtually guaranteeing that the Board would be required to use the full statutory period.[6]

The Board should not adopt its proposals relating to conditions to enhance competition over and above the enhanced competition that flows from a merger itself. Nor should the Board adopt its proposals with respect to downstream transactions, voting trusts, and transnational mergers, or change its proven approach to three-to-two reductions.

II. THE PROPOSED RULES WOULD UNNECESSARILY SUBSTITUTE REGULATION FOR THE MARKET AND CONFER EXCESSIVE DISCRETION ON THE BOARD, WITH CORRESPONDING UNCERTAINTY IN THE PRIVATE SECTOR

The Board has proposed a new "paradigm" in which applicants would be required not only, as under the Board's present policies, to demonstrate public benefits flowing directly from the merger in the form of increased efficiencies, improved service, and the increased competition that flows from such improvements, and not only to remedy identified competitive harms or other public costs, but to enhance competition through separate conditions that are not direct offsets to the identified public costs, and to anticipate future mergers and demonstrate that the proposed merger would remain consistent with the public interest in light of those anticipated mergers. These requirements would not minimize federal regulatory controls or facilitate private initiatives. Instead, they would displace the market with regulation, and introduce tremendous uncertainty, even though such displacement and uncertainty are not necessary to ensure

[6]Further, under the open-ended provisions the Board could claim more latitude to reject an application as "incomplete" after 30 days, or short of a prima facie case in a summary disposition. Such rejection could trigger another round of time-consuming preparation and negotiation, if applicants chose to proceed at all.

consistency with the public interest. These new regulatory burdens should not be imposed. The Board can ensure that future mergers are consistent with the public interest by the panoply of other proposed requirements that would enable increased scrutiny of the public benefits and costs of proposed mergers, and with which CN does not disagree.

A. **Enhanced Competition**

The Board would require applicants "to propose conditions that will not simply preserve but also enhance competition." Proposed § 1180.1(d). The Board premises this requirement on the assumption that every major merger will cause reductions in competition that cannot be offset "directly and proportionately," and that all such mergers will carry a significant risk of service disruptions despite "extraordinary steps" to avoid them. Proposed §§ 1180.1(c), (c)(2)(i), (iii).

These provisions would confer extraordinary discretion on the Board to require regulatory restructuring, and generate corresponding uncertainty for parties attempting to evaluate possible mergers. Conditions would no longer be logically bounded by the nature and extent of the competitive harm the merger would cause. Because enhancements would be neither direct nor proportional, there would be no gauge for determining how much enhancement would be enough. Moreover, there is no apparent way for the Board to compare harms and benefits; for example, how would the Board compare a reduction in geographic competition at certain locations with removal elsewhere of "paper" and "steel" barriers? How would the Board assess the sufficiency of proposed enhancements when the shippers that would experience the irremediable reduction in competition would not be the shippers that benefit from the enhancement? And how could railroads considering a merger assess what they would likely be required to do?

Insofar as the requirement for enhancement is premised on the Board's view that every major merger carries some unavoidable risk of significant service disruptions, how would the Board know what the size of this risk is and how much enhancement is enough to offset it? What would be the common yardstick that enables an apples-and-oranges comparison of service risk with competition enhancement? And how could applicants make reasonable assessments of these matters in advance? The nature and magnitude of the uncertainties can only interfere with the efficient functioning of the market for control.[7]

Embedded in the Board's proposal to require conditions to enhance competition are assumptions that may fairly be stated as follows: *First*, any merger between two Class I railroads will always entail (a) irremediable reductions in competition, and (b) a risk of significant service disruptions. *Second*, the combined negative values of these two effects will always outweigh the combined positive values of the increased efficiencies, improved service, and increased competition arising from the merger itself.

These assumptions are not supportable. Parties enter into mergers in order to increase efficiency and improve service, and, as the Board has recognized, those results in turn increase competition against other railroads and other modes.[8] Quantified direct public benefits found by the Board in recent major mergers (largely productive efficiencies) have been in the hundreds of millions of dollars, and even these do not capture the unquantified direct public benefits such as service improvements and increases in competition. As economist Christopher Vellturo stated on behalf of CN during the ANPR phase:

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[7]The open-ended nature of the assessment required by the Board's proposal, with no meaningful standards to constrain the Board's exercise of discretion, could raise a serious issue of unconstitutional delegation. *See generally American Trucking Ass'ns, Inc. v. EPA*, 175 F.3d 1027 (D.C. Cir.), *modified on other grounds*, 195 F.3d 4 (D.C. Cir. 1999), *cert. granted*, 120 S. Ct. 2003 (May 22, 2000) (No. 99-1257).

[8]"[E]xperience has shown that the competitive response of competing carriers following Commission approval of a consolidation will dramatically alter a marketplace's dynamics." *Southern Pacific Transp. Co. v. ICC*, 736 F.2d 708, 718 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1208 (1985); *accord, CSX/NS/CR*, Decision No. 89, slip op. at 130, 133 (STB served July 23, 1998) (public benefits include improved efficiency that will make the applicants "more competitive with trucking" and expanded single-line service that will "increase competition between railroads and other modes"); *BN/SF*, Decision No. 38, slip op. at 59 (ICC served Aug. 23, 1995) (shippers "will benefit from extended market coverage, which will result in new competition for other railroads, trucks, and water carriers"); *Union Pac. Corp. - Control - Missouri Pac. Corp.*, 366 I.C.C. 462, 488 (1982) *("UP/MP")* ("Because competition itself benefits the public, the anticipated competitive responses of other carriers to a consolidation are public benefits"), *aff'd in part and remanded in part sub nom. Southern Pac. Transp. Co. v. ICC*, 736 F.2d 708 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1208 (1983).

> The reduction of redundant capacity . . . by no means represented the sole significant basis for improvements in rail service and efficiency. Indeed, key factors – including network reconfiguration and extension, enhanced economies and product differentiation through length of haul increases, and improved utilization and management of rolling stock – continue to offer the potential for large gains in efficiency and social welfare through merger.

CN ANPR Comments, Statement of Christopher A. Vellturo, at 69.

The Board could have no basis for finding that the direct public benefits of every future major merger will never outweigh any unremediable reductions in competition and unavoidable significant service risks, even assuming *arguendo* that every future merger will present such reductions and risks.[9] Indeed, there is no basis for a general finding that every future merger between Class I railroads will cause reductions in competition that cannot be directly and proportionately remedied, and experience is to the contrary.

The "enhancement" requirement would thus rest on an unsupportable regulatory finding that would preclude case-by-case examination of competitive and market realities. The result would be to impose costs on transactions through "enhancement" conditions that are not in fact necessary to make the transaction consistent with the public interest. This unnecessary regulation would be detrimental to all rail constituencies. Railroads might decide to forego transactions that would yield substantial net public benefits, without unremedied competitive harms, because the competition-enhancing conditions would require too great a sacrifice of private benefits. The Board need not and should not require enhancement through conditions, separate from the enhanced competition that flows from the increased efficiency and service improvements that result from the merger itself.[10]

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[9] In *UP/MP*, the ICC recognized that, where a transaction "threatens harm to the public interest," and feasible offsetting conditions cannot be fashioned, the ICC should nevertheless *approve* the merger "without conditions" if the merger "offers benefits that outweigh the threatened harm." 366 I.C.C. at 563-64. On both policy and legal grounds, the ICC rejected KCS's position that the ICC should "impose conditions on mergers for the purpose of enhancing competition where adequate competition does not exist." *Id.* at 563-65.

[10] The Board could allow enhancement through conditions as an option for applicants in the
(continued...)

It bears mention that the proposed enhancement requirement would be contrary to the evolution of antitrust law over the past two decades. The findings described above constitute a per se rule that future Class I merger are inconsistent with the public interest in the absence of conditions to enhance competition. As the Board is aware, a per se rule condemns a business practice without case-by-case inquiry into its business purposes or effects, on the ground that the practice could not possibly have redeeming competitive value.[11] The evolution of antitrust law, however, has been *away* from per se rules to rule-of-reason analysis, in which the particular facts are examined in detail.[12] Courts and antitrust enforcers have shifted away from per se rules precisely in order to avoid displacing market decisions with legal constraints where a full understanding of the facts would reveal that such displacement is unnecessary to preserve competition and may instead foreclose procompetitive activities.[13]

CN recognizes that, under the public interest standard, the Board has broader authority than an antitrust court. It can disapprove mergers that the antitrust laws would allow, and

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[10](...continued)
unlikely event that there are identified competitive harms that are not directly and proportionately remediable. This would avoid imposing a per se rule that would unnecessarily displace the market with regulation, and causing applicants to forego mergers that would in fact confer substantial net public benefits. By limiting the occasions when enhancement would be at issue, and taking enhancement into account only when there are identified competitive harms that are not directly and proportionately remediable, the option alternative would limit the uncertainty created by the inherent analytic difficulties in evaluating enhancement proposals under the public interest standard.

[11]*See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49-50 (1977), quoting *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

[12]For two decades beginning in the late 1970s, the Supreme Court "transformed antitrust by restricting the reach of the per se rules and expanding the scope of the rule of reason." Thomas C. Arthur, *A Workable Rule of Reason: A Less Ambitious Antitrust Role For The Federal Courts*, 68 Antitrust L.J. 337 (2000). Illustrations include *State Oil v. Kahn*, 522 U.S. 3 (1997) (overruling per se rule); *Continental TV*, *supra* note 11(same).

[13]The ICC and Board practice since the Staggers Act has been entirely consistent with this evolution toward highly specific factual analysis, for example, in the Board's treatment of three-to-two circumstances. The proposed "enhancement" requirement would be a break in the opposite direction. As with per se rules generally, this per se rule would impose unnecessary costs and would unnecessarily replace market decisions with regulatory decisions.

approve mergers that those laws would condemn.[14] But competition is an element of the public interest.[15] With respect to that element, the Board has looked to the antitrust laws for guidance.[16] It would be suspect policy, to say the least, to take an approach to the competition aspect of rail mergers that is fundamentally in the opposite direction from that of antitrust enforcement. Adoption of a per se rule would be particularly inappropriate for the Board, which has an expertise and institutional capacity to examine industry facts that courts lack, and which has been explicitly directed by Congress to minimize federal regulatory controls under a deregulatory statute.

B. <u>Preservation of Competition: Three-to-two</u>

The Board has a well-developed analytic approach to three-to-two reductions. As CN pointed out in its opening comments in the ANPR phase, this approach "has proven accurate, and it is flexible enough to take account of any factors that bear on the likelihood of a reduction in competition from a three-to-two change." CN ANPR Comments 39-40. The Board's approach takes into account the same factors that are identified in the DOJ/FTC Merger Guidelines, and provides applicants with sufficient predictability to evaluate whether they are likely to be required to grant access to third railroads at three-to-two locations. This predictability can be highly important in valuing the probable net private benefits of a transaction.

The NOPR, however, might be read to indicate a change in the Board's approach to three-to-two reductions. Proposed § 1180.7(b)(2) (market analyses) would require applicants to "list points where the number of serving railroads would drop from two to one and from three to two,

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[14] *UP/MP*, 366 I.C.C. at 485, citing *United States v. ICC*, 396 U.S. 491, 513-14 (1970).

[15] *McLean Trucking Co. v United States*, 321 U.S. 67, 87-88 (1944); *UP/MP*, 366 I.C.C. at 501.

[16] *UP/MP*, 366 I.C.C. at 503; *CSX/NS/CR*, Decision No. 89, slip op. at 49 (STB served July 23, 1988).

respectively, as a result of the proposed transaction (both before and after applying proposed remedies for competitive harm)."[17]

CN has no objection to a requirement that applicants list all three-to-two points. Such a requirement facilitates the Board's present, proven approach. The Board should make clear, however, that the listing of three-to-two points does not carry with it any basic change in the Board's approach to three-to-two reductions

C. **Downstream Transactions**

The Board faces circumstances in which the number of Class I railroads is small; one merger may lead to another; and the ultimate prospect of a transcontinental duopoly engenders unease among some. There are two basic choices in responding to these circumstances. The first is to require additional information with respect to competition, service, and benefits, and apply modern tools of competition analysis, to ensure that each successive merger, in light of all prior mergers, will not reduce competition and is otherwise consistent with the public interest. The second is to attempt to introduce into the analysis itself additional elements that somehow directly examine the supposed effects of hypothesized future mergers.

The Board is proposing to do both. The first makes sense; the second cannot be done in a principled fashion and would unnecessarily expand regulation in a substantial departure from the basic deregulatory tenets of the Act. The proper response to the likelihood of future mergers and a possible transcontinental duopoly is careful scrutiny of actual transactions, not abstract and hypothetical speculation. As Professor Bernard S. Black of the Stanford Law School states in a verified statement accompanying these Comments, there is no "plausible scenario in which this

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[17]Further, proposed § 1180.1(a) states that the Board "does not favor consolidations that reduce the railroad and other transportation alternatives available to shippers unless there are substantial and demonstrable public benefits to the transaction that cannot otherwise be achieved." The comparable language in the present policy statement refers to "substantial" reductions in competition, following the language of § 7 of the Clayton Act, which allows evaluation under the rule of reason and does not mechanically draw conclusions based on head counts. This properly non-mechanistic approach has led the Board to distinguish three-to-two from two-to-one reductions.

highly speculative review will enhance economic efficiency." Verified Statement of Professor Bernard S. Black on Behalf of Canadian National Railway, at 10 (Nov. 17, 2000) ("Black V.S.").[18] In demonstrating this to be the case, Professor Black makes the most favorable possible assumption for the Board, that "downstream review produces a perfect assessment of the efficiency gains or loses from a future merger." *Id.* at 11-13.

With respect to careful scrutiny, the Board has correctly stated that, under its proposals, applicants would bear a "heavier burden." NOPR 10. For example, applicants would have to satisfy new requirements for detailed market analyses; present a detailed "route level review" showing how operational changes will translate into benefits for shippers (which in turn increase competition as other rail carriers and other modes respond); provide more analysis of geographic and product competition and of the post-merger competitive position of Class II and III railroads; provide service assurances to shippers and connecting railroads; and, through "full-system" plans, provide more information to show that operations in Canada or Mexico will not have adverse operating impacts in the U.S. While reserving the right to oppose unreasonable applications of these provisions, CN agrees with these proposals in principle and in most of the particulars.

The Board has the tools, and will have sharpened them at the completion of this rulemaking to protect the public interest through careful analysis of each transaction as it arises. The Board has well-developed and well-understood modes of analysis to determine when a merger between two railroads that compete in the same transportation markets will be likely to reduce competition. The Board can analyze geographic and product competition involving different origins or destinations as well as intramodal competition between the same origin and destination. The Board's requirements for Service Assurance Plans and Safety Implementation Plans will enable detailed examination of the manageability and customer-responsiveness of

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[18]Page references herein are to the internal pagination in the Black Statement, which is located at the top of each page; the consecutive pagination is at the bottom of each page.

larger railroads, taking into account advances in information technologies and new operating techniques.

Under the downstream transactions proposal, in contrast, the Board would require applicants to speculate as to responsive mergers and then, building speculation on speculation, "measure" their own benefits in light of the hypothetical future mergers, as well as evaluate the need for further conditions, and the desirability of the resultant industry structure. The Board would then impose its own industrial policy by accepting or rejecting the projected industry structure, thereby displacing the market and picking winners and losers in the abstract. As CN described at length in its opening and reply comments, there is no analytic framework for doing this, and the Board proposes none. *See* CN ANPR Comments 21-28, CN ANPR Reply Comments 20-21, 31-39.

The result would be that the Board would have substituted its view of a preferred industry structure for the industry structure that would be generated by a series of private, market-based initiatives. This would be the *de facto* effect of the proposal, whatever the Board's professed intention. That effect would echo the central planning role for the Board that Congress rejected in the Transportation Act of 1940.[19] The proper response to the likelihood of future mergers and a possible transcontinental duopoly is careful scrutiny of actual transactions, not abstract and hypothetical speculation.

The pitfalls in the proposal to examine downstream transactions are confirmed by the history of similar notions under the antitrust laws. In the 1960s, the Supreme Court issued several decisions stating that, in section 7 antitrust cases, reviewing courts and federal agencies

[19] 54 Stat. 898, 905 (1940). As described by the Supreme Court: in the Transportation Act of 1940, the ICC was "finally relieved of its duty to promulgate a national consolidation plan, and the power to initiate mergers and consolidations was left completely in the hands of the carriers." *St. Joe Paper Co. v. Atlantic Coast Line Railroad Co.*, 347 U.S. 298, 319 (1954).

should consider "trends toward concentration" in the relevant industry in approving or rejecting future mergers.[20]

The 1960s cases that announced the "merger trend" strand of "incipiency" have not been fruitful; they have not generated any analytic framework separate from and in addition to the analysis of the pending transaction.[21] Courts have not introduced additional elements into merger analysis to analyze directly the supposed effects of a general merger trend or particular predicted or hypothesized mergers or some assumed final industry structure. No court has found a merger otherwise lawful to be unlawful in light of anticipated anticompetitive effects of future mergers, or has found a merger otherwise unlawful to be lawful in light of anticipated benefits of future mergers.[22] Such matters are simply not addressed. The Merger Guidelines, which identify in step-by-step fashion the way in which the DOJ and FTC will analyze mergers, make no mention at all of downstream transactions, merger trends, eventual industry structure, or the like, except insofar as they take account of the prospects of future entry.[23]

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[20]Notable among these cases are *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), *United States v. Von's Grocery*, 384 U.S. 270 (1966), and *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966).

[21]The variant of the "incipiency doctrine" announced in these cases reflected that era's approaches to merger analysis, which no longer prevail, including the view that "big" is necessarily "bad," the antitrust laws should protect not only competition but competitors, and preserving all existing choices is more important than increasing efficiency; indeed, that increases in efficiency could be anticompetitive. Further, these decisions antedated by decades the development of the modern tools of competition analysis now employed by antitrust enforcers to evaluate when a reduction in the number of competitors is likely to reduce competition. These tools are embedded in the FTC/DOJ Merger Guidelines.

[22]*See* Robert H. Lande, *Resurrecting Incipiency: From Von's Grocery to Consumer Choice and Beyond*, 68 Antitrust L.J. (forthcoming Winter 2000) (quoting 1992 Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104, § 2.1 (Apr. 2, 1992)). A preliminary version of Professor Lande's article was distributed at the American Bar Association Antitrust Section's "Antitrust at the Millennium" Symposium (Sep. 11-12, 2000).

[23]The 1968 Merger Guidelines contained a section entitled "Market With Trend Toward Concentration" that was dropped in the 1982 Merger Guidelines. *See* 4 Trade Reg. Rep. (CCH) ¶ 13,101, § 7 (1968); 47 Fed. Reg. 28493 (1982).

This is not to say that antitrust enforcement ignores increasing concentration in particular industries. But it recognizes such a trend by applying the standard analyses with special care in such industries to ensure that significant reductions in competition from each merger under review are identified and remedied.[24] Antitrust enforcement does not attempt to predict who is likely to merge with whom, or what the hypothetical benefits and harms of such predicted mergers would be in relation to the benefits or harms of the pending merger.[25]

The Board will better protect the public interest through careful scrutiny than through attempts to incorporate hypothetical analysis that would unnecessarily displace the market with regulation and impose tremendous regulatory costs without remotely corresponding benefits. That is the only way to proceed -- with an adequate understanding of the facts. It is the only way to avoid unnecessarily displacing a market-driven evolution of industry structure with regulation, and to adhere to the statutory directive to minimize federal regulatory controls. And it is the only way to avoid intractable analytic and evidentiary problems that could preclude coherent or fair proceedings.

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[24] *See, e.g.*, Exxon Corp.; Analysis To Aid Public Comment and Commissioner Statements, 65 Fed. Reg. 2618, 2626-27 (FTC Jan. 18, 2000) (separate statement of Chairman Robert Pitofsky and Commissioners Sheila F. Anthony and Mozelle W. Thompson) (noting that recent mergers in the oil industry have "significantly increased" concentration; and that, accordingly, the FTC, in approving merger between Exxon and Mobil, had been "demanding" in requiring remedies where there were "significant competitive overlaps" in "markets where competition was likely to be affected adversely," and that it would "review any future mergers in this industry with special concern").

[25] For example, although FTC Chairman Robert Pitofsky has noted *Brown Shoe's* admonition to take account of merger trends, Robert Pitofsky, The Nature and Limits of Restructuring in Merger Review, Remarks at Cutting Edge Antitrust Conference (Feb. 17, 2000), *at* http://www.ftc.gov/speeches/pitofsky/restruct.htm, he is reported to have remarked recently, with respect to the proposed merger of U.S. Airways and United Airlines, that "it would be 'unfair' to the merging companies to speculate over whether these other [rumored airline mergers] really will happen." Jaret Seiberg, *From Out of the Past*, The Daily Deal, June 26, 2000, at 3, http://www.thedailydeal.com/features/todaysfeature/A24634-2000Jun26.html. "'There are so many rumors about so many deals.' Pitofsky said, 'We don't take those into account.'" *Id.*

D. Voting Trusts

The Board's proposal to apply a public interest test in addition to a no-control test to proposed voting trusts would move the Board into uncharted territory. For example, what would be the elements of the public interest apart from whether the voting trust sufficiently insulates from control?

Further, applying a public interest standard could involve the Board in second-guessing the applicants' allocation between them of regulatory risk during the pendency of the merger proceeding. This would be a very deep and unnecessary incursion into private initiatives and market outcomes, and could directly and without justification affect the valuation (the price, the stock exchange-ratios, the assumption of debt) agreed to by the applicants. It is even unclear whether applying the public interest standard might involve the Board in deciding whether it was in the public interest for the acquired railroad to remain in play during the pendency of the merger proceeding. This, too, would be a very deep regulatory incursion into the market for control.

The Board's authority is to apply the public interest standard in the context of a merger proceeding to decide whether a "transaction" that confers control is in the public interest. A voting trust is designed to avoid control, not achieve it. Use of a voting trust meeting the Board's guidelines has the effect of placing that transaction outside the Board's public interest jurisdiction. Thus, applicants that ask for staff review of a voting trust under existing regulations are asking for confirmation of that position, but there is no statutory requirement that they must seek that confirmation. Since the transaction in trust is outside the Board's purview and there has been no change in the status quo other than in the ultimate beneficial interest in stock, there is also no need and no statutory requirement that the Board review the public interest in the trust.

It is true that the Board's moratorium decision applied the public interest standard outside the context of a merger proceeding, but it did so in the unique circumstance where the agency believed that it could not any longer properly apply the standard in merger proceedings. The court of appeals declined to second-guess the Board's view that the ancillary public interest determination was necessary to the proper fulfillment of the Board's statutory duty. That is not the case with respect to voting trusts, and the Board should not apply the public interest standard to voting trusts as it has proposed. The Board should apply the public interest test as Congress intended, to the merits of control transactions at the conclusion of a merger proceeding.

In addition to the proposal to apply a public interest standard, the Board proposes to require applicants to submit voting trusts for its approval, rather than leaving that choice to applicants, as is now the case. The Board's proposal would impose regulation in place of the market by not allowing merger applicants to determine if they prefer to assume the regulatory risk of unauthorized control during the pendency of their merger proceeding before the Board. The proposed requirement for prior approval even under the familiar no-control standard could be a substantial regulatory impediment in circumstances where managements agree to move quickly to secure shareholder approval and to consummate, using a voting trust. It could also impede hostile takeovers initiated through tender offers, which typically require use of a voting trust. The Board may or may not analyze the ultimate public interest merits of a hostile takeover differently from a friendly takeover, but there is no reason that its voting trust regulation should inhibit such mergers at the outset.

The Board can properly aid applicants and further the purposes of the Act with respect to avoiding unauthorized control by standing ready to evaluate voting trusts under the control criteria, if applicants request it to do so. The Board should allow applicants to decide whether to assume the regulatory risk of unauthorized control, and should not require applicants to obtain prior approval before employing a voting trust. Where applicants choose to seek Board approval, providing opportunity for comments and reply comments would be reasonable.

III. THE BOARD SHOULD EVALUATE TRANSNATIONAL MERGERS IN A MANNER THAT FURTHERS THE PUBLIC INTEREST ENVISAGED BY CONGRESS WHEN IT APPROVED NAFTA, AND SHOULD APPLY STANDARDS UNIFORMLY, WITHOUT ARBITRARY DISCRIMINATION, TO ALL CARRIERS AND ALL TRANSACTIONS

The Board has proposed a number of reasonable requirements to increase its ability to identify impacts within the U.S. of transnational mergers. For example, applicants would be required to submit "full-system" plans, including operations in Canada and Mexico. These analyses would enable the Board to determine the "competitive, service, employee, safety, and environmental impacts of the prospective operations within the United States." Proposed § 1180.1(k). The employee impact exhibit (proposed § 1180.6(b)(9)) would be required to show employment changes in countries outside the U.S. NOPR 30. The Board states that it will no longer be likely to waive its requirements for "applicant carriers" with respect to rail carriers located entirely in foreign countries. *Id.* at 24. And the Board's increased emphasis on geographic and product competition, and on the effects of a merger on Class II and III railroads, and on ports, could mean more examination in particular cases of activities outside the U.S. for their impacts in the U.S. While any regulatory requirement creates the possibility of unreasonable application, CN does not in principle oppose these requirements, which, consistently with NAFTA, turn on the nature of the impacts, and not the foreignness of the applicants.

The Board, however, has also proposed a series of additional requirements that would apply only in the case of transnational mergers (that are also "major" mergers). *See* proposed §§ 1180.0, 1180.1(k), 1180.11.[26] In effect, the Board's requirements would impose special requirements on foreign applicants.

These proposed requirements are unreasonable. Given the structure of the Board's rules with respect to a "prima facie" case and a "complete" application, the Board, by requiring only

[26]The Board does not define "transnational mergers." CN assumes that the Board would consider to be "transnational" a future merger between CN (which controls two Class I railroads) and a Class I railroad.

applicants in transnational mergers to provide information on the enumerated subjects, would be adding additional elements to a foreign applicant's prima facie case that it does not require in the prima facie case of a domestic applicant.[27] Under these proposals, even if no party had raised any credible concern particular to the transaction, the Board apparently would decline to find that a transnational transaction is in the public interest unless foreign applicants had somehow dispelled unspecified concerns relating to the enumerated subjects. The Board in effect would be adopting a presumption that transnational mergers, simply because they are transnational, are contrary to the public interest because of unspecified issues relating to the enumerated subjects.

These proposals would apply to a company such as CN that is a wholly privatized publicly traded corporation incorporated in a NAFTA signatory. These requirements would not further the interests in trade and investment across borders that Congress found to be in the public interest and sought to further through its approval of NAFTA.[28] They would presume that Congress's general expectations in approving NAFTA should be presumed to be incorrect with respect to the enumerated subjects, notwithstanding the absence of evidence supporting that conclusion and the experience that supports Congress's view. And they would unreasonably discriminate between foreign and domestic applicants.

The Board can stand ready to entertain credible evidence on any of these matters if and when proffered by a party to a proceeding. Where such evidence, if unrebutted, would establish some particular cause for concern under the public interest standard, applicants in a transnational

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[27]An application presents a prima facie case if it contains all of the facts that, if accepted as true, demonstrate that the application is in the public interest. 49 C.F.R. § 1180.4(c)(8). If the Board concludes that the application is missing an element in the prima facie case, the Board may issue a show-cause order and dismiss the application in a summary denial procedure without an evidentiary hearing. *Railroad Consolidation Procedures Expedited Processing*, 366 I.C.C. 767, 769-70 (1980). Also, the Board will dismiss an application within 30 days of its filing if the Board deems the application not "complete" in that it does not contain "all information" that the Board's rules require. 49 C.F.R. § 1180.4(c)(7).

[28]*See, e.g.*, H.R. Rep. No. 103-361, pt. 1, at 9, 15-16, *reprinted in* 1993 U.S.C.C.A.N. 2552, 2559, 2565-66 (NAFTA "is in the U.S. national interest" and should result in "substantial benefits for the U.S. economy"). As noted earlier (*supra* note 2), NAFTA was approved by both Houses of Congress.

merger would have every reason to respond, and an inadequate response could lead the Board to deny the application. But the Board should not require such applicants to bear a burden of coming forward with evidence in the first instance when there is no apparent issue to be resolved.

A. <u>The NAFTA Framework</u>

As the Board is aware, NAFTA is the guiding economic framework for trade and investment for the three North American Parties -- the U.S., Canada, and Mexico. Among the specific objectives of NAFTA as set out in Article 102, "Objectives," the Parties pledged to "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services" between the U.S., Canada, and Mexico, and to "increase substantially investment opportunities" for NAFTA investors in North America. 32 I.L.M. at 297. The overriding aim of NAFTA is to achieve closer integration of the three North American economies, not only in the provision of goods and services but also in transportation and investment. NAFTA was designed to create an economic environment in which an investor's nationality plays no role in domestic regulatory decisions.

Article 1102 of NAFTA states that "[e]ach Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or disposition of investments." 32 I.L.M. at 639. A finding of "unlike" circumstances obviously requires more than the bare fact that the investor is foreign. There is no basis for the Board to presume that domestic railroads and wholly privatized publicly traded foreign railroads are not in "like circumstances" with respect to their willingness to cooperate with FRA, their freedom from political controls that would subvert their profit-maximizing incentives, their lack of ownership restrictions of a type damaging to the public interest, and their willingness to continue to meet defense needs.

The applicability of NAFTA to freight railroads was an advertent decision of the NAFTA signatories. The predecessor agreement, the Canadian American Free Trade Agreement

("CAFTA"), specifically excluded rail transportation from trade liberalization.[29] Each of the NAFTA signatories had the opportunity to exempt its rail sector from NAFTA liberalization obligations. Each government did take such reservations in other transportation sectors, such as air and trucking. But the U.S. did not do so, with respect to rail, indicating the U.S. commitment to fully liberalize the North American rail industry.

As the synopsis developed by the three signatories states, NAFTA "provides for the phase out of restrictions on cross-border land transportation services among the three countries in order to create equal opportunities in the North American international land transportation market."[30] NAFTA is designed "to ensure that the land transportation services industries of the three countries will have full opportunity to enhance their competitiveness without being placed at a disadvantage during the transition to liberalized trade."[31] Mergers are of course one way to enhance competitiveness. Any regulatory agency, if it is to act consistently with the public interest as Congress has defined it through NAFTA, bears a high burden if it chooses to discriminate against NAFTA applicants, here by presuming that transnational mergers are contrary to the public interest in respect of the enumerated subjects.

That burden is not met here. The Board proposes to "consult with relevant officials as appropriate" to ensure that its actions in merger cases conform to NAFTA and other international agreements. Proposed § 1180.1(k). The Board cannot save an otherwise inappropriate requirement by promising to consult to make it right. The special requirements that the Board would impose on transnational mergers would by themselves prejudice interests that Congress

[29]CAFTA did not include transportation services among the services covered by Chapter 14 ("Services"), and it expressly excluded "the provision of transportation services" from the liberalized investment provisions of Chapter 16 ("Investment"). Free-Trade Agreement, Jan. 2, 1988, U.S.-Can., Annex 1408, 27 I.L.M. 281, 362-64; *id.*, art. 1601(2), 27 I.L.M. at 373.

[30]*See* Governments of Canada, the United Mexican States, and the United States of America, Description of the Proposed North American Free Trade Agreement, at 11 (Aug. 12, 1992) ("NAFTA Description").

[31]*Id.*

has embedded in the public interest through its approval of NAFTA, and are otherwise unreasonable.[32]

B. Safety

Safety is of course an important issue under the public interest standard. The Board addresses that issue by proposing extensive requirements relating to the operating plan and Safety Integration Plan to be developed by applicants working with FRA. These requirements would apply to transnational mergers, just as they do to domestic mergers. The Board goes further, however, and imposes a special requirement on foreign railroads to "explain how cooperation with the Federal Railroad Administration will be maintained without regard to the national origins of merger applicants." Proposed § 1180.11(a). There is no reasonable basis for this additional requirement, which would require foreign applicants to profess their good faith simply because they are foreign. Congress, finding NAFTA to be in the public interest,[33] did not expect NAFTA to undercut the efficacy of U.S. regulation, including safety regulation, that the U.S. did not specifically "reserve" under NAFTA for different treatment. Congress approved NAFTA on the implicit assumption that Canadian and Mexican corporations with operations in the U.S. would not, as a general matter, be less willing than domestic corporations to abide by U.S. laws and cooperate with regulatory agencies as appropriate. The Board is proposing on an across the board basis to presume otherwise with respect to cooperation with FRA, without adequate basis.

Moreover, the public interest in harmonizing safety requirements across NAFTA borders is addressed in mechanisms established in NAFTA itself. NAFTA binds the U.S. (and thus the Board) to address the conformity of safety standards in land transportation services under a

[32] CN has analyzed the Board's proposals relating to transnational mergers as a railroad incorporated in Canada, and has not examined Mexican laws that may be applicable to railroads incorporated in Mexico. Whether or not the same considerations would apply to a transnational merger involving a Mexican railroad, the Board cannot adopt merger rules that are unreasonably over-inclusive.

[33] *See* H.R. Rep. No. 103-361, *supra* note 28, pt. 1 at 9, 15-16.

particular framework that is very different from the one proposed by the Board. The NAFTA signatories endeavored to make compatible their standard-related measures with respect to rail operations, including locomotives and other rail equipment and operating personnel standards relevant to cross-border operations.[34]

Specifically, under Article 913 of NAFTA, 32 I.L.M. at 390-91, the three NAFTA countries established a Committee on Standards-Related Measures, comprising representatives from each country. The Committee, in turn, has established a Land Transportation Standard Committee to oversee commitments on safety standardization by member countries. In addition, a "Rail Operations" working group has been established. These existing institutions provide a mechanism for encouraging safety and other standards in the operation of railroads across borders, as an ongoing effort not limited to transnational mergers. Any regulatory agency must discharge a high burden of necessity to presume that this mechanism, adopted by Congress as in the public interest, is insufficient to deal with specifically transnational issues in rail safety. There is no such basis here.

Congress's assumption that Canadian and Mexican corporations with operations in the U.S. would generally adhere to U.S. laws is reinforced with respect to rail safety by experience and common sense. There already are substantial railroads in the U.S. that are foreign-owned. For example, Canadian Pacific Railway Company owns Soo, a Class I railroad which operates in the upper Midwest. CP also has a minority interest in I&M, which operates in Illinois, Iowa, Missouri, and Minnesota. CN owns Grand Trunk Western Railroad, a Class I railroad which operates in Michigan, Illinois, and Ohio. CN also owns Illinois Central Railroad Company, a Class I railroad company, which runs from Chicago to the Gulf.

It hardly needs saying that the incentives of foreign railroads operating in the U.S. are no different from those of U.S. railroads with respect to safety. Each has strong moral, legal, economic, and contractual reasons to operate safely, and to cooperate with FRA in order to do so.

[34]*See* NAFTA Description, *supra* note 30, at 12.

Merger applicants have a strong self-interest in cooperating with FRA in the development of a Safety Integration Plan so as not to jeopardize the Board's approval. The FRA no doubt at times finds the performance of both domestic and foreign-owned railroads capable of improvement, but that is because people make mistakes and regulators and the regulated will sometimes disagree, and not because a railroad is foreign-owned. There is no evidence to show that Canadian or Mexican ownership of rail assets in the U.S. has diminished cooperation with the FRA, or that the operation of such assets has entailed safety problems attributable to their foreign ownership.

Further, if there were issues of cooperation or performance attributable to foreign ownership and not reasonably left to the NAFTA transnational safety mechanisms, they would not be specific to mergers, and the merger rules would not be the place to address them. Regardless of ownership, any railroad operating in the U.S. is obligated to do so safely, in conformance with FRA regulations. A merger does not create or end that obligation. After a transnational merger, the obligation applies to foreign-owned rail assets in the U.S. just as it does to other rail assets in the U.S.

If some particular feature of a transnational merger called into question the FRA's ability to enforce its regulations, applicants would no doubt present evidence themselves as part of the application. For example, if applicants were proposing to move dispatching of U.S. rail assets to a foreign country, applicants could be expected to assess that proposal in the operating plan with respect to operational efficiency and safety. That would be true even if applicants were proposing to move dispatching from one U.S. location to another, and no special provision is required for transnational moves.[35]

[35] If applicants were not proposing to move dispatching, the Board could nevertheless impose a condition requiring prior notice before any such move were undertaken. In the *CN/IC* proceeding, applicants agreed that they would not transfer dispatching of operations on the IC lines to Canada without prior consultation with FRA. *CN/IC*, Decision No. 37, slip op. at 45 (STB served May 25, 1999).

In any event, as with safety generally, foreign dispatching is not a merger-specific issue. DOT pointed out in its ANPR comments that FRA is "working on a rulemaking to address this subject definitively." Initial Comments of the United States Department of Transportation, at 32-33 (filed May 16, 2000), *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1). The FRA has published a regulatory agenda including a proposed interim final rule that would require that all railroad operations in the U.S. be dispatched in the U.S.[36] Thus, the possibility of foreign dispatching provides no basis for a discriminatory requirement that applicants in transnational mergers demonstrate that they will cooperate with FRA.

More generally, if applicants failed to address some element of a transaction that raised particular safety concerns, the issues would be raised by the numerous parties in a merger proceeding with every incentive to pursue such issues. DOT, for example, is a party that can assert FRA concerns. Trucking and chemical companies have raised rail safety issues in merger proceedings, as have unions. Applicants -- domestic or foreign -- will find it in their own interest to respond when parties raise credible concerns. But it is contrary to NAFTA and arbitrary to impose an across-the-board generic requirement that foreign applicants profess their good faith with respect to safety simply because they are foreign.

C. **National or Provincial Goals**

The proposed rules would require applicants for approval of transnational mergers to "assess the likelihood that commercial decisions made by foreign railroads could be based on national or provincial rather than broader economic considerations, and be detrimental to the interests of the United States." Proposed § 1180.11(b). The Board is apparently unwilling to presume that wholly privatized and publicly traded railroads incorporated in a NAFTA partner are profit-maximizing enterprises.

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[36] 65 Fed. Reg. 23,252, 23,257 (Apr. 24, 2000); *see also New Safety Regs*, RAIL Intelligence, Nov. 13, 2000, at 4 (reporting that FRA "is readying for publication" its proposed rule on dispatching).

This is not a reasonable proposal as applied to such companies in an era of globalization whose hallmark is multi-national corporations successfully pursuing their *economic* interests across borders and without regard to their places of incorporation. There would have to be something very peculiar about wholly privatized and publicly traded freight railroads to legitimate an across-the-board concern that they are instruments of national or provincial political agendas that displace normal economic incentives.[37] There is no evidence of such peculiarity, and the public policy of the U.S., as well as the behavior of the capital markets, are to the contrary.

Thus, as already discussed, the NAFTA signatories agreed to "increase substantially investment opportunities" across their borders. To that end, they agreed that "each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or disposition of investment." NAFTA, art. 1102, para. 1, 32 I.L.M. at 639.

Congress approved these provisions in the belief that they would increase the economic welfare of the U.S. That belief is not compatible with a belief that it was providing entree to foreign investors so that they could pursue political goals detrimental to the U.S. The Board, however, is presuming just that. Instead of accepting Congress's general assumption until disproven, the Board would require foreign applicants to explain in their prima facie case why Congress's general assumption that NAFTA investment would increase the economic welfare of the U.S. is accurate as to them. There is no basis for this reversal of Congressional policy, and nothing that would satisfy the high burden on an agency to justify discrimination against NAFTA applicants. The Board can stand ready to entertain credible evidence that the Congressional policy is inapplicable as to a particular applicant, but, as with the other proposals relating

[37]Both CN and the CP holding company are publicly traded, including on the New York Stock Exchange.

exclusively to transnational mergers, it should not impose nationality-based requirements for the prima facie case of NAFTA applicants.

Congress's assumption that NAFTA investors would seek economic rather than political goals is reinforced by the capital markets. As private (and capital-intensive) enterprises, foreign railroads must compete in the most competitive of all markets - the global capital markets. There they compete not only with U.S. railroads but with every other opportunity available to investors that poses comparable risk. If equity investors ever were to perceive that a railroad was not a profit-maximizing enterprise, they would simply go elsewhere. This is true not only of new equity investment but of the railroad's own earnings. Stockholders would not allow a railroad to retain earnings for further investment in the enterprise, and would instead demand their distribution so that they could put their money elsewhere. CN, for example, is 60 % U.S.-owned, and U.S. shareholders would have no interest in sacrificing returns to support some Canadian national or provincial political goals.[18] As Professor Black (who is an expert in corporate acquisitions, including international acquisitions, and corporate finance) points out, "investors and analysts value Canadian firms in the same way that they value U.S. firms." Black V.S. at

[18]The Canada Business Corporations Act ("CBCA"), under which CN is incorporated, requires that a majority of directors be "resident Canadians." CBCA, R.S.C., ch. C-44, § 105(3) (Can.). NAFTA specifically allowed this provision. *See* NAFTA, Annex I - Canada, 32 I.L.M. at 708 (explicitly reserving this provision of the CBCA for all sectors). The CBCA "is a modern, well-respected corporation law." Black V.S., at 17. Approximately 8 to 10 thousand corporations incorporate under the CBCA each year, and are subject to this residency provision, including such corporations as Nortel and Bombardier. CN discloses this provision in public filings with the SEC. *See, e.g.*, Form F-4, Canadian National Railway Company, at 81 (filed Mar. 1998); Form F-4 and S-4, amdt. 4, Canadian National Railway Company and North American Railways, Inc. (filed Mar. 10, 2000). As with U.S. corporate laws, the CBCA imposes a fiduciary duty on directors to manage the company in the "best interests of the corporation." CBCA, § 122(1). If investors considered the residency provision to indicate other than profit-maximizing motives, they would not invest. In fact, however, the residency provision is a "minor matter." Black V.S. at 19. There is "no evidence that the nationality of board members affects firm performance or decisions. Even much more significant differences in board composition, such as whether a board has a majority of independent directors, do not have a significant effect on firm performance." *Id.*

18.[39] The capital markets simply do not share the premise of the Board's proposal. And for an agency of the U.S. to endorse such a premise could establish a precedent that could be invoked to the disadvantage of U.S. companies operating in other countries throughout the world.

Absent strong evidence to the contrary in a particular proceeding, the Board cannot reasonably require applicants to prove a negative – the absence of political control. The proposal would impose on foreign applicants the risk and uncertainty of litigating in the dark without knowing any particular contention that they are rebutting. If the Board were to adopt the proposal, then, in every merger between a foreign and a U.S. railroad, the Board could assume the regulatory role of dissecting and evaluating the economic motivations of the foreign railroad's management, without any threshold showing that such an inquiry is called for and without discernible standards. To disfavor foreign applicants in this way would be poor policy and could not be squared with NAFTA.

The Board should not impose an across-the-board regulatory requirement in place of the judgment of Congress that NAFTA investment in the U.S. increases the economic welfare of the U.S., or in place of the day-in, day-out judgments of hundreds of thousands of investors who, by continuing to invest, demonstrate their belief that theirs is a profit-maximizing enterprise. It is impermissibly discriminatory to require wholly privatized publicly traded applicants incorporated in a NAFTA signatory to somehow marshal evidence on this issue absent any showing by anybody of strong evidence to the contrary. Again, if these issues are raised by parties with real concerns, they should be addressed on a case-by-case basis.

D. <u>Ownership Restrictions</u>

The Board proposes that applicants in major transnational mergers be required to "address how any ownership restrictions imposed by foreign governments should affect [the Board's] public interest assessment." Proposed § 1180.1(k); *see also* proposed § 1180.11(b). As

[39]For example, analysts "generally apply the same target price/earnings (P/E) ratios to U.S. and Canadian railroads." Black V.S. at 18.

the Board is aware, this requirement, if adopted, would apply in the event of a CN application for approval of a major transaction, because the CN Commercialisation Act limits the ownership of CN voting stock by any one person or association of persons to 15%.[40] This ownership restriction is without regard to nationality. It applies to acquisition by a Canadian person just as it does to acquisition by a person of any other nationality. The Board's proposed rule would apply to any ownership restriction imposed by a foreign government, including a restriction such as the one applicable to CN that is nationality-blind. CN's comments assume that this was the Board's intent.

The Board's proposal, as with the other special requirements relating to transnational mergers, would require a new element in a foreign applicant's prima facie case. Here, the Board is saying that, without evidence explaining ownership restrictions imposed by a foreign government, it could not find any transnational merger to be in the public interest. The Board is in effect adopting a presumption that ownership restrictions imposed by a foreign government are contrary to the public interest. As CN will show, these requirements do not reflect a view that ownership restrictions in general may be contrary to the public interest, but only that *foreign* ownership restrictions may be contrary to the public interest.

There is no basis for such a requirement. As Professor Black states, the "starting point for analysis is to recognize that – as any experienced corporate lawyer knows – in a merger between *A* and *B*, which company becomes the surviving corporate parent of the merged firm is a matter of corporate form, that generally has no substantive significance." Black V.S. at 19.

From the perspective of NAFTA, foreign and domestic applicants are in "like circumstances" with respect to ownership restrictions. Ownership restrictions are not unique to foreign railroads. Major U.S. railroads have them, too. These restrictions typically come into play when someone, acting alone or in concert with others, seeks to acquire more than a set

[40]CN Commercialisation Act, S.C. 1995, ch. 24, § 8(1) (Can.).

percentage of a railroad's outstanding capital stock. The set percentage varies from railroad to railroad, but usually falls within the 10%-to-20% range.

The ownership restrictions come in several forms and are imposed in a variety of ways. Some are imposed through shareholder rights plans known as "poison pills" that are adopted by the railroad's board of directors; others arise under statutory provisions that similarly inhibit or handicap large stock acquisitions where the acquirer is seeking control of the company. For example, NS recently adopted a "Rights Plan" which would be triggered by a tender offer for the acquisition of 15% or more of NS's common stock.[41] The Rights Plan, among other things, entitles holders of Rights – other than the acquiring person or group – to purchase NS shares at a 50% discount, thereby making the proposed acquisition uneconomic.

Similarly, CSX recently amended its existing rights plan by lowering the trigger from 20% to 10%. CSX stated that it took this step in response to notification from Carl Icahn of his intention to acquire up to 15% of CSX's common stock.[42] Under CSX's plan, each right entitles shareholders (other than the would-be acquirer) to purchase preferred stock at a specified exercise price, or, under certain circumstances, to obtain additional shares of common stock in exchange for their rights. Again, the effect of these provisions would be to make the proposed acquisition uneconomic. Likewise, BNSF, while allowing a takeover by simple majority, has availed itself of a Delaware statute (where it is incorporated) that allows its board of directors to exclude the voting rights of a would-be acquiror in a shareholder vote on the acquiror's merger proposal.[43]

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[41]News Release, Norfolk Southern Corporation, Norfolk Southern Adopts Shareholder Rights Plan (Sept. 26, 2000), http://www.nscorp/com/nscorp.html/home.html.

[42]Press Release, CSX Corporation, CSX Announces Amendment to Rights Plan (June 27, 2000), http://www.csx.com/aboutus/news/press/pressview.cfm?ID=3285 ("CSX Rights Plan Press Release").

[43]Del. Code Ann., tit. 8, § 203 (1999). The statute provides certain exceptions, for example, if the disinterested directors determine that the would-be acquiror owns at least 80% of the voting stock and intends to vote in favor of the proposed transaction.

In addition to these self-administered ownership restrictions, CSX and NS are each protected by provisions of the Virginia Stock Corporation Act (under which each is incorporated) that require super-majorities of each group of shareholders entitled to vote, in order to approve a merger.[44] The statute excludes the voting rights of the would-be acquiror for purposes of such voting. This is another form of state-administered ownership restriction. Neither CSX nor NS has opted out of these provisions.

Ownership restrictions, whatever the source, tend to have a common objective -- protection against corporate raiders and hostile takeovers.[45] And, they all have the same goal -- the terms and conditions of acquisitions, when they do occur, should be reached through arms-length negotiation by the parties and should be of mutual benefit to the shareholders and other stakeholders of each. Where parties are each willing to go forward with a proposed merger, ownership restrictions will not preclude them from doing so.[46]

Either these types of provisions presumptively raise concerns under the public interest standard or they do not. It is not foreignness but the nature of the restrictions that does or does not presumptively require explanation. To tie the requirement of explanation to foreignness is arbitrary. It would impose without sufficient reason an additional element of a prima facie case for foreign applicants that should be borne by both foreign and domestic applicants or by neither.

CN believes that these types of provisions do not raise issues under the public interest

[44]Va. Code § 13.1-718.E (Michie 1999).

[45]Thus, in announcing the recent amendment to its rights plan in response to notification from Carl Icahn, CSX stated that the rights plan "is designed to protect shareholders against abusive takeover tactics." CSX Rights Plan Press Release. The Delaware statute was enacted for the same purpose. *See* 66 Del. Laws, ch. 204 (1988).

[46]This is as true of the statutory ownership restriction applicable to CN as it is to restrictions contained in a corporation's governing documents and securities. CN and BNSF negotiated a no-premium "merger of equals" utilizing a Delaware holding company and a stapled stock structure that was consistent with the Canadian law barring the acquisition of more than 15% of CN's stock by a single person acting alone or with associated persons. The 15% restriction, which limits acquisitions of the corporate entity, did not preclude a combination that both parties believed would realize the efficiencies of integrating their networks and enhance value for shippers and stockholders.

standard and provide no basis for an additional requirement in the prima facie case, whether of domestic or foreign applicants. The railroad examples noted above are of course not unique; U.S. corporations routinely adopt these types of provisions. The Board has never before considered such provisions to raise concerns. The ICCTA itself allows states to require super-majorities for control transactions, which means that Congress did not consider special restrictions relating to acquisitions to be inconsistent with the public interest.[47] For the STB now to presume otherwise would be to interpose regulation deeply into matters of corporate structure and governance, for no apparent or sufficient purpose. An acquisition by a corporate entity that could not itself be acquired is not presumptively contrary to the public interest.[48] In any event, there is no reasonable basis for imposing a requirement on NAFTA applicants but not domestic ones with respect to ownership restrictions.

E. **National Defense**.

Proposed § 1180.1(l) would require all applicants, domestic or foreign, to "discuss and assess the national defense ramifications of their proposed merger." CN has no objection to this proposal, which ensures that merger applicants address the types of concerns that the Defense Department in the past has raised, such as possible abandonments or service disruptions. Addressing such concerns would not ordinarily require applicants to have any specific or expert knowledge of defense matters; they must develop a detailed service plan and identify proposed abandonments in any event.

Proposed § 1180.11(c), however, which applies only in the case of transnational mergers, also requires applicants to discuss national defense ramifications. If this separate requirement

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[47] 49 U.S.C. § 11321(a) provides that a railroad may carry out a control transaction "only with the assent of a majority, or the number required under applicable State law, of the votes of the holders of the capital stock of that corporation entitled to vote."

[48] As already noted, such a corporation can nevertheless enter into mutually beneficial mergers that enable it and the merger partner to realize the efficiencies in their assets and benefit their customers and shareholders.

has any additional meaning, it presumably would require something more than is required of domestic applicants in order to establish a prima facie case. An additional requirement for unspecified defense elements in a foreign applicant's prima facie case would be unreasonable.

Congress obviously did not presume when it adopted NAFTA that free trade in the provision of land transportation and investments in land transportation would be generally inconsistent with the public interest in defense. It assumed the opposite, with the safeguard of NAFTA Article 2102, which allows signatories to limit free trade to protect their national security. The background to this exception was a similar exception in the General Agreement on Tariffs and Trade (GATT), which has been rarely invoked because of fear of undermining the general system of free trade.[49] The expectations of the NAFTA signatories reflected this background.

A U.S. agency should impose defense-related requirements that discriminate against NAFTA applicants only when demonstrably necessary. Any such demonstration should come in the first instance from the Department of Defense. That Department is best able to identify defense concerns that are beyond the normal transportation concerns of the type identified above. Foreign ownership of U.S. railroads, so far as CN is aware, has been uneventful from a defense point of view, both in times of peace and war.[50] Applicants in transnational mergers cannot reasonably be expected to identify defense concerns that are not suggested by experience and that the Defense Department has not previously raised. Applicants do not have the knowledge or expertise in the web of defense arrangements with the U.S.'s two NAFTA neighbors, nor the Defense Department's own perceptions of its defense needs in various contingencies.[51]

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[49]*See* John H. Jackson, The World Trading System: Law and Policy for International Economic Relations 204-05 (1989).

[50]Canada, a joint member of both the North American Air Defense Command and the North Atlantic Treaty Organization, is the closest military ally of the U.S.

[51]Indeed, in the unlikely event that a transnational merger posed a sensitive defense issue, the Defense Department might well prefer to have a choice of bringing the matter to the President (continued...)

CONCLUSION

The Board has proposed a number of amendments to its merger rules that will enable it to take reasonable account of recent experience and future prospects in the rail industry. Through reasonable applications of those amended rules, the Board will be able to protect the public interest while remaining faithful to the deregulatory mandates of the Act, avoiding unnecessary displacement of the market by regulation, retaining a reasonable measure of predictability for parties considering mergers, and avoiding arbitrary discrimination against NAFTA applicants. Each of these limits would be exceeded if the Board were to adopt its proposals relating to conditions to enhance competition, downstream transactions, voting trusts, and transnational mergers. The Board need not and should not adopt them.

Respectfully submitted,

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November 17, 2000

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[51](...continued)
under the Exon-Florio Amendment rather than being required to litigate before the Board, as it would be required to do if applicants bear the burden of coming forward on the issue. Since 1988, this legislation has given the President the power to suspend any foreign acquisition when national security could be threatened or impaired. *See* 50 App. U.S.C. § 2170.

Surface Transportation Board

Ex Parte No. 582 (Sub-No. 1)

Major Rail Consolidation Procedures

Verified Statement

of

Professor Bernard S. Black

17 November 2000

on Behalf of Canadian National Railway

Outline of Contents

I. Qualifications

I am Professor of Law at Stanford Law School. My curriculum vitae is attached to this Report as Appendix *A*. At Stanford, I teach courses in, among other subjects, Corporations, Corporate Finance, and Corporate Acquisitions.

I am a coauthor of Ronald Gilson & Bernard Black, *The Law and Finance of Corporate Acquisitions* (2d ed. 1995 and supplement 1999), which I believe to be the leading law school textbook on corporate acquisitions. I am also an author or coauthor of Bernard Black, Reinier Kraakman & Anna Tarassova, *Guide to the Russian Law on Joint Stock Companies* (1998); Bernard Black, *Fundamentals of Negotiating and Drafting Acquisition Agreements* (1998); and numerous professional articles. My professional articles are listed in my curriculum vitae.

I joined Stanford Law School in 1998, after 10 years on the Columbia Law School faculty. During 1994-1995, I worked in Moscow, Russia as a legal advisor to the Russian Securities Commission. I served as Counsel to Commissioner Joseph Grundfest of the Securities and Exchange Commission from 1987-1988 and practiced corporate law from 1983-1987 at Skadden, Arps, Slate, Meagher & Flom, in the mergers and acquisitions group. From 1982-1983, I was a law clerk to Judge Patricia M. Wald of the United States Court of Appeals for the District of Columbia Circuit. I received a J.D. degree from Stanford Law School in 1982.

I have served, at various times since 1993, as an advisor to the Governments of Armenia, Indonesia, Korea, Mongolia, Russia, Ukraine, and Vietnam on corporate and securities law. I was a drafter or advisor for the Russian Law on Joint Stock Companies (1995) and Law on Limited Liability Companies (1998); the Mongolian Law on Companies (1999); and the Vietnamese Law on Companies (1999).

I am the editor of two electronic journals, *Corporate and Securities Law Abstracts* and *Corporate Governance and Finance Law Abstracts*, a former chair of the Association of American Law Schools section on Business Associations, and a former member of the New York City Bar Association Committees on Corporation Law and on the Independent States of the Former Soviet Union.

I consider myself to be qualified to act as an expert in the fields of corporate law, corporate acquisitions, and international corporate governance.

II. Summary

It is my professional opinion that:

(i) Any regulatory disadvantage that the Surface Transportation Board ("STB") imposes on a foreign bidder that proposes to acquire a U.S. railroad will reduce the foreign bidder's chances of success and distort the market for corporate control. If a U.S. bidder and a foreign bidder offer the same price and other terms, a target railroad's board of directors and shareholders will favor the U.S. bidder.

(ii) More generally, some major rail mergers will involve greater efficiencies – greater customer and shareholder gains – than others. STB rules that distort the market for corporate control increase the chance that suboptimal mergers will occur. Merger decisions that ought to be based on expected efficiency gains will instead be based too heavily on the parties' guesses about STB approval.

(iii) Regulatory risks that merging parties can't predict in advance, such as the STB plan to impose conditions that enhance competition (not just offset a merger's anticompetitive effects) and to consider future "downstream" transactions, will discourage railroads from proposing efficiency-enhancing mergers. These requirements raise the expected cost of the conditions that the STB will attach to a merger; increase risk (because the regulatory outcome is less predictable); increase the odds of outright failure (through STB disapproval or because the STB imposes unacceptable conditions); and lengthen the approval process. These factors all operate in the same direction – to discourage mergers.

(iv) The central economics lesson of the last century is the enormous advantage of decentralized decisionmaking by private profit-maximizing firms over central planning by government agencies. Regulatory intervention in mergers is appropriate primarily to limit the creation or exercise of monopoly power. Assuming the regulators succeed in this, the best measure of efficiency gains is the bidder's willingness to pay a premium for the target's shares, together with the target's willingness to accept the bidder's merger proposal instead of pursuing other possible mergers or remaining independent. A regulatory decision that a merger will or won't bring economic benefits is a pale substitute for this market-based judgment.

(v) The STB's proposal to assess the efficiency of possible downstream mergers, when one merger is proposed, is an astonishing exercise in central planning. This review is highly speculative and unlikely to enhance economic efficiency. Its most likely effect will be to increase the cost of merger proceedings, to delay or block the efficiency gains from mergers and cause parties to propose mergers based on the likelihood of STB approval, rather than on expected efficiency gains.

(vi) The presumption that the market should determine which rail combinations are best is weaker for a government-owned bidder, which may not maximize profit. Thus, the STB could reasonably impose additional requirements on *government-owned* bidders. These requirements should not apply to *privately owned* bidders like Canadian National ("CN") or Canadian Pacific ("CP"), that are merely incorporated in Canada instead of the United States.[1]

(vii) Today, CN and CP are the only foreign firms that own class I railroads.[2] The STB's proposed Major Rail Consolidation Procedures ("Merger Rules") are unlikely to ever apply to any other foreign firm, and are even more unlikely to ever apply to a government-owned firm. Instead of writing rules to govern hypothetical foreign bidders other than CN and CP or hypothetical government-owned bidders, the STB can rely on its existing power to require additional submissions as part of the prima facie case for a merger if that situation arises.

(viii) Canadian firms are subject to the same fiduciary duties as U.S. firms. They must act in their shareholders' interests, not in national or provincial interests. Their managers have strong incentives to do so. There are countries (Russia is a notable example) where investors apply a "corporate governance discount" because of concern about whether firms in those countries will respect shareholder interests. But investors and analysts value Canadian firms in the same way that they value U.S. firms. I know of no evidence that Canadian firms place national or provincial interests ahead of their shareholders' interests.

(ix) Proposed § 1180.1 l(a) requires a foreign bidder to "explain how cooperation with the Federal Railroad Administration will be maintained without regard to the national origins of merger applicants." This requirement discriminates against foreign bidders without factual basis, and thereby distorts the market for corporate control. I am aware of no evidence, in the rail industry or

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[1] Abbreviations used in this Report are consistent with those in the Notice of Proposed Rulemaking.

[2] In this Statement, I refer to a foreign-incorporated firm as a "foreign" firm, to a Canadian-incorporated firm as a "Canadian firm," and to a U.S.-incorporated firm as a "U.S. firm."

other industries, that Canadian incorporation, or foreign incorporation more generally, affects compliance with safety, environmental, or other regulatory requirements.

(x) Proposed § 1180.11(b) requires a foreign bidder to "assess the likelihood that commercial decisions . . . could be based on national or provincial rather than broader economic considerations, and be detrimental to the interests of the United States." This requirement is unsound as applied to privately owned foreign bidders, because there is no evidence that privately owned foreign firms behave in this manner. This requirement discriminates against foreign bidders and thereby distorts the market for corporate control. If retained, it should apply only to government-owned bidders (which currently don't exist).

(xi) Proposed § 1180.11(b) requires a foreign bidder to "discuss any ownership restrictions imposed on them by foreign governments." If this clause refers to restrictions on foreign ownership, then in my opinion, CN has no such restrictions. A single shareholder can't own more than 15% of CN's shares, but this restriction applies equally to Canadian and non-Canadian shareholders. There is no reason why this restriction will affect the expected efficiency gains from a merger. To reduce regulatory distortion in the market for corporate control, the STB should clarify that ownership restrictions such as CN's, that apply equally to domestic and foreign shareholders, are outside the scope of this requirement.

(xii) Proposed § 1180.11(c) requires a foreign bidder to "discuss and assess the national defense ramifications of the proposed merger." I believe that this requirement is unsound as applied to a privately owned foreign bidder. It discriminates against foreign bidders and thereby distorts the market for corporate control. I know of no evidence that foreign firms are less likely than U.S. firms to cooperate with the U.S. government in meeting defense needs. CN and CP, the only foreign firms that own class I railroads, have a long history of meeting defense needs. Moreover, if a railroad doesn't cooperate with the U.S. government in a war or other emergency, the government has ample recourse, including taking control of track and dispatching centers in the U.S. Carriers know this, so they have every incentive to cooperate with the government in the first place. If retained, this requirement should apply only to government-owned bidders.

(xiii) STB rail merger hearings are generally hotly contested. If the requirements of § 1180.11 are narrowed as I propose above, the Federal Railroad Administration ("FRA"), the Department of Defense, or a merger opponent could still argue in a particular case that a foreign bidder may not comply with FRA rules, may base its decisions on national or provincial interests, may not cooperate with defense needs, or is subject to ownership restrictions that affect merger efficiency. The STB can consider these arguments as part of its overall merger review. I consider it unlikely that credible evidence will be offered on any of these issues.

III. Regulatory Versus Market Decisions on Mergers

A. The Advantages of Market Decisions over Regulatory Decisions

The overwhelming view of academic researchers is that government review of mergers should be narrowly limited. The government should rely on the market to determine which mergers make economic sense. The best measure of whether a merger will bring competitive benefits is the bidder's willingness to pay a premium for the target's shares, and the willingness of the target's board of directors and shareholders to accept a merger proposal. Market participants will surely make mistakes, but they will make fewer mistakes than regulators. They have better information, and better incentives (their own money is at stake). And they have strong incentives to take post-merger corrective actions to fix whatever problems emerge.

The STB's merger review process is astonishingly intrusive, by comparison to other industries. The combination of unspecified competition enhancing conditions, the STB's effort to secondguess the parties' judgment about net efficiency gains, and its consideration of future downstream mergers, has no parallel, even among other regulated industries. The reasons for intrusive review may be rooted in history (including the STB's governing statute), but that does not justify the STB in stretching its statutory mandate and making its review even more intrusive than it already is. The justification for more intrusive review is not apparent.

The academic preference for market decisions over regulatory decisions is part of a more general truth. The central economics lesson of the last century is the enormous advantage of decentralized decisionmaking by private profit-maximizing firms, over central planning by government agencies. A regulatory decision that a merger will or won't bring economic benefits is a pale substitute for the market-based judgments of the bidder and target firms.

The presumption that the market should determine which rail combinations are best is weaker for a government-owned bidder, which may not maximize profit. Thus, the STB could reasonably impose additional requirements on *government-owned* bidders.[3] These requirements should not apply to privately owned bidders like CN and CP that are merely incorporated in a country other than the United States.

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[3] An appropriate definition of a government-owned bidder, for this purpose, would be: "A firm, the majority of whose voting shares are owned directly or indirectly by a government, or whose operating decisions are in another way controlled by a government."

B. The Proper Scope of Regulatory Review

From a policy perspective, the most important regulatory role is ensuring that a merger does not have anticompetitive effects. STB merger review already treats this as a major goal, and extends as well to safety, service, labor and environmental issues. Additional regulatory scrutiny might be warranted if rail retained the importance to the U.S. economy that it had when the railroad regulatory structure was put in place. But this is not the case. Any possible rail merger is dwarfed in size by many other mergers that occasion far less regulatory oversight.

Table I offers one measure of the size of the major railroads relative to other U.S. companies. It lists the market capitalization of the major railroads and their rank among all U.S. publicly traded firms. No individual railroad ranks higher than 191 in market capitalization. All six together, if considered as a single firm, would rank only 58th and would have a market capitalization equal to only 0.38% of the entire U.S. stock market.

Table I: Market Capitalization of Major Railroads
(dollars in $ billions; market capitalization rankings based on Russell 3000 index)

Railroad	Market Capitalization	Rank Among U.S. Firms Based on Market Capitalization
Burlington Northern & Santa Fe (BN)	$11.5	209
CN	6.5	291*
CP	8.9	243*
CSX Corp. (CSX)	5.7	306
Norfolk Southern (NS)	5.9	303
Union Pacific (UP)	13.5	191
All Major Railroads Combined	**$52.0**	**58****
Total U.S. Market Capitalization	**$13,650**	---

* hypothetical rank if included in the Russell 3000 index
** hypothetical rank if considered as a single firm

The risk that private actors will complete a merger that produces fewer efficiency gains that the parties expect – or no efficiency gains at all -- is accepted elsewhere in the economy as one of the risks that attend a market economy. The railroads' status as part of the transportation infrastructure may justify strong efforts to preserve competition, as well as reasonable oversight to reduce the risk of major service disruptions. It does not justify seeking to protect the public against what would be at most minor efficiency losses from an unwise merger.

To take an extreme example, suppose that a railroad merger would destroy value equal to 10% of the market capitalization of both railroads combined – a far larger amount than is plausible for a merger where the merging companies expect significant efficiency *gains*. That would imply one-time losses from a merger of two of the big six railroads of $1-2 billion – a tiny number when measured against annual U.S. gross domestic product of almost $10 *trillion*.

Another risk from intrusive review is that the STB will refight the last war in its decisions. Consider, for example, the service disruptions suffered in the UP-SP and CSX/NS-Conrail transactions. The railroads involved suffered huge losses in revenue, profit, and goodwill. The risk of service disruptions is now widely understood. It will be embedded in firms' judgments about the efficiencies of a proposed merger and how to carry out integration. Merger participants have huge incentives to avoid service disruptions. And shippers can negotiate themselves for contractual compensation for any disruptions that occur.

It is not clear that regulatory oversight can add much to these private incentives. The STB's best response to the risk of service disruptions may be to review post-merger integration plans, rather than to try to take the risk of disruptions into account in deciding whether to approve a merger. Any effort by the STB to assign a dollar value to service disruption risk would be highly speculative. The

STB would face the impossible task of quantifying the probability of each possible disruption, the economic significance of each, and the likely duration of each. Yet without such a dollar value, the STB can't sensibly compare this risk to the merger's potential efficiency gains.

C. Which Foreign Firms Will the Merger Rules Apply To?

Today, CN and CP are the only foreign firms that own class I railroads. The Merger Rules are unlikely to ever apply to any other foreign firm. It's even more unlikely that the Merger Rules will ever apply to a *government-owned* bidder. Instead of writing rules to govern hypothetical foreign bidders other than CN and CP, or hypothetical government-owned bidders, the STB can rely on its existing power to require additional submissions as part of the prima facie case for a merger if that situation arises.

D. The Illogic of Considering Downstream Mergers

The STB's proposal to assess the efficiency of possible downstream mergers, when one merger is proposed, is an astonishing exercise in central planning. I cannot imagine a plausible scenario in which this highly speculative review will enhance economic efficiency. Its principal effect will be to increase the cost of merger proceedings, delay or block the efficiency gains that mergers can bring, and cause parties to propose mergers based on the likelihood of STB approval, rather than expected efficiency gains.

If the STB could conduct downstream review perfectly – with accurate prediction of the future efficiency gains from downstream mergers -- it would be virtually certain that the STB's decision on the merger before it would be the same, with or without downstream review. Consider a simplified example, in which there are four class I railroads, *A* and *C* in the West, and *B* and *D* in the East. *A* proposes to merge with *B*. This may lead *C* and *D* to merge. The other realistic possibility is that *A* could merge with *D*, provoking a *B-C* merger proposal. I will assume that one-at-a-time review of the *A-B* merger includes assessing traffic and operating impacts for *unmerged* *C* and *D*. The STB's proposal for downstream review is not well-defined, but I will assume that it involves assessing in the *A-B* proceeding the expected efficiency gains (losses) from a future *C-D* merger. I will also assume that (i) downstream review produces a perfect assessment of the efficiency gains or losses from a future merger; and (ii) that assessment will be the same at the time of the *A-B* merger as at the time of an actual *C-D* merger proposal.

Downstream review, in this example, will never change the STB's decision whether to approve the *A-B* merger. Suppose first that (i) the *A-B* merger, evaluated under one-at-a-time review, is expected to produce efficiency gains (net public benefits); and (ii) given the A-B merger, a future *C-D* merger, evaluated under downstream review, is expected to bring additional efficiency gains. Then the STB will approve the *A-B* merger under either standard of review (and will approve the *C-D* merger if proposed).

Suppose, second, that: (i) the *A-B* merger, evaluated under one-at-a-time review, is expected to bring efficiency gains; and (ii) given the *A-B* merger, a future *C-D* merger, evaluated under downstream review, is expected *not* to bring additional efficiency gains. Then under one-at-a-time review, the *A-B* merger will be approved (and the *C-D* merger will be disapproved if proposed). Downstream review in the *A-B* proceeding will take the expected future disapproval of a *C-D* merger into account, and reach the same conclusions.

Suppose, third, that: (i) the *A-B* merger, evaluated under one-at-a-time review, is expected to bring efficiency *losses*; but (ii) given the *A-B* merger, a future *C-D* merger, evaluated under downstream review, is expected to bring efficiency gains. The STB will disapprove the *A-B* merger under one-at-a-time review. It will almost surely disapprove the *A-B* merger under downstream review as well. Even if the *C-D* merger will bring larger gains with a prior merger of *A-B* than without this prior merger, it's highly unlikely that these incremental efficiency gains from a *C-D* merger, which won't take place for a while and may never be proposed at all, will outweigh the immediate efficiency losses from the *A-B* merger. Nor is it clear that, even if it wanted to, the STB could approve an *A-B* merger that will bring efficiency losses, because that merger may increase the public benefits from a future *C-D* merger that may never occur.

Suppose, fourth, that: (i) the *A-B* merger, evaluated under one-at-a-time review, is expected to bring efficiency losses; and (ii) given the *A-B* merger, a future *C-D* merger, evaluated under downstream review, is expected to bring further losses. Then both mergers will be disapproved under either standard of review.

The table below summarizes this analysis. It lists all possible combinations of efficiency gains or losses from each possible merger, and how the STB would respond, under the *current* one-at-a-time rules and under downstream review. The outcome is identical in all cases.

Outcome of STB Merger Review under One-at-a-Time and Downstream Review

Efficiency Gains (Net Public Benefits) from *A-B*, under one-at-a-time review	Expected Efficiency Gains from *C-D*, *given A-B*, under downstream review	Result for *A-B* under One-at-a-Time Review	Result for *A-B* under Downstream Review
yes	yes	approved	approved
yes	no	approved	approved
no	yes	rejected	rejected
no	no	rejected	rejected

The example above assumes perfect STB assessment of the efficiency effects of future mergers. In the real world, the STB's assessment of which downstream mergers are likely to occur, and their potential efficiency effects, will be uncertain, due to limited information and the multiple possible mergers that the STB must consider. The world may also change between the time of the *A-B* merger proposal and the later time when a *C-D* merger would actually be proposed. Thus, the STB may err in evaluating the likely effects of a downstream merger.

These potential errors still won't not lead to different outcomes in the *A-B* merger proceeding under one-at-a-time review and downstream review. As the table shows, the assessment in the *A-B* proceeding of the future gains (losses) from a *C-D* merger doesn't change the STB's decision on the *A-B* merger. This remains the case if the STB conducts the *C-D* analysis with error. Thus, downstream review adds to the complexity and length of the *A-B* proceeding, yet won't change the outcome.

Downstream review can theoretically produce a different outcome than one-at-a-time review, if it is broadly interpreted to allow the STB to decide which mergers are best out of all possible mergers, proposed or not, and disapprove all others. This would be a uniquely intrusive exercise in central-planning, perhaps beyond the STB's power. But let me analyze this possibility to illustrate how unlikely it is that this form of downstream review will increase efficiency.

To stay with my prior example, assume that both *A-B* and *C-D* are efficiency enhancing. Under one-at-a-time review, the STB will approve both mergers. Suppose, however, that the STB believes, under downstream review, that *A-D* and *B-C* mergers would produce greater total efficiency, and therefore rejects the proposed *A-B* merger. In rejecting the *A-B* merger, the STB would be pitting its judgment against the market's. That the *A-B* merger was proposed is evidence that the boards of directors of *A*, *B*, and *D* consider *A-B* to have higher synergy potential than *A-D*.

The market will be right more often than the STB. Market participants have better information and incentives than the STB. But let me assume that the STB's judgment is better than the market's. The STB still cannot force private firms to bring about its preferred outcome. If the STB rejects the *A-B* merger, *A* and *B* may forswear future mergers, pursue a contractual alliance that delivers fewer efficiency gains than either merger outcome, or fight the STB's decision in the courts. At best, the STB's preferred outcome will take place with a delay measured in years. The true choice is not between *A-B* today and *A-D* today, but between *A-B* today and the *possibility* of *A-D*, some years hence.

The combination of uncertainty about whether an *A-D* merger will take, the certainty of substantial delay before an *A-D* merger can take place, and the likely harm to *A* and *B* from rejecting the *A-B* merger, almost guarantees that the STB is better off approving an efficiency-enhancing *A-B* merger that is before it, even if it would have preferred an *A-D* merger, completed today, to an *A-B* merger today.

IV. Regulatory Distortions in the Market for Corporate Control

Any rail merger proposal must compete with a number of alternatives, including: other merger proposals made to the target railroad (explicit competition in the market for corporate control); other potential mergers that the target could explore if it wants to (implicit competition in the market for corporate control); partial integration through joint ventures or other contractual arrangements; and doing nothing. As between competing merger proposals, the proposal that offers the largest efficiency gains will tend to succeed, because that acquirer can offer a higher price than other acquirers without harming its own shareholders. Similarly, a merger will generally be proposed only if it promises larger efficiency gains than nonmerger alternatives.

I discuss below several specific proposed STB rules that apply specifically to foreign bidders. None rests on sound policy reasons. All will distort the market for corporate control, and the distortions will be cumulative. Any regulatory disadvantage that the STB imposes on a foreign bidder that proposes to acquire a U.S. railroad will reduce the foreign bidder's chances of success in this implicit or explicit competitive bidding process. If a U.S. and a foreign bidder offer the same price and other terms, a target railroad's board of directors and shareholders will favor the U.S. bidder.

These regulatory distortions will increase the chances that suboptimal mergers – mergers that promise smaller efficiency gains than other potential mergers – will occur. Merger decisions that ought to be based on expected efficiency gains will instead be based too heavily on the parties' guesses about STB approval.

Regulatory risks that merging parties can't predict in advance, such as the ill-defined STB plan to impose conditions that enhance competition (not just offset a merger's anticompetitive effects) and to consider future "downstream" transactions, will discourage railroads from proposing efficiency-enhancing mergers. These requirements raise the expected cost of the conditions that the STB will attach to a merger; increase risk (because the regulatory outcome is less predictable); increase the odds of outright failure (through STB disapproval or because the STB imposes unacceptable conditions); and lengthen the approval process. These factors all operate in the same direction – to discourage mergers.

This effect can be illustrated with a hypothetical example. Assume that:

- Railroads *A* and *B* are considering a merger that, if completed today, would bring expected shareholder gains of $500 million in present value.[4]
- Expected regulatory delay is 18 months.
- The risk-adjusted market rate of return is 10% per year.
- The expected cost of conditions to be imposed by the STB is $200 million, in present value (if imposed today)
- The risk of regulatory disapproval (or imposition of unacceptable conditions) is 25%
- The expected cost of regulatory disapproval, in harm to the merging railroads during the merger pendency period, is $1 billion.[5]

Under these assumptions, the merger has a 75% chance of producing net gains to the merging firms of $500 million − $200 million = $300 million. These would be achieved 18 months (1.5 years) from today, for expected present value to the merging firms of:

Expected gain from approval $= (.75)(\$300 \text{ million})/(1.10)^{1.5} = \$195 \text{ million}$

But the expected cost of disapproval is:

Expected cost of disapproval $= (.25)(\$1{,}000 \text{ million}) = \$250 \text{ million}$

Under these circumstances, the merger won't be proposed. The net shareholder gains, and the likely additional gains to customers from enhanced competition, will be lost.

This specific result depends on my numerical assumptions. But the general point remains: If railroads expect large potential regulatory costs due to aggressive STB conditions, the risk that the STB will reject an efficiency-enhancing merger, or both, some efficiency-enhancing mergers may never be proposed.

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[4] This estimate is broadly consistent with evidence on the magnitude of shareholder wealth gains from mergers generally. *See* Ronald Gilson & Bernard Black, *The Law and Finance of Corporate Acquisitions* ch. 8 (2d ed. 1995) (reviewing the evidence on operating synergy gains from mergers).

[5] This expected cost of disapproval reflects both industry experience (in the one recent disapproved major rail merger, the SP emerged greatly weakened) and experience with takeovers generally. Reasons to expect harm from failed mergers include: (i) while a merger is pending, both parties are reluctant to make major investments or strategic decisions, and the target is often contractually barred from doing so; (ii) while a merger is pending, the target's employees feel that their jobs are at risk and the best employees often leave; and (iii) employee morale at the target firm is disrupted, even for employees who remain. The length of STB proceedings magnifies the potential losses.

V. Specific STB Proposals

A. Cooperation with the Federal Railroad Administration

Proposed § 1180.11(a) requires a foreign bidder to "explain how cooperation with the Federal Railroad Administration will be maintained without regard to the national origins of merger applicants." I believe that this requirement is unsound. It discriminates against foreign bidders and thereby distorts the market for corporate control. I know of no evidence, in the rail industry or other industries, that foreign incorporation affects firms' compliance with safety, environmental, or other regulatory requirements. Neither the STB nor ANPR commenters has offered any such evidence. Thus, I see no rational basis for the STB to worry that foreign firms will act differently than U.S. firms in this respect. Such a concern is especially farfetched for CN and CP, the only foreign firms that own class I railroads. Both have long operated in the U.S.

The STB's concern is trebly unsupported. It is unsupported first because there is no evidence that a problem exists; second because there is direct contrary experience for the only two firms - CN and CP -- to which the rule would apply; and third because any such risk is best addressed by the FRA when and if a safety issue arises, rather than through STB speculation in advance of an actual problem.

B. Decisions Based on National or Provincial Interests

The Canadian Business Corporations Act is a modern, well-respected corporation law. It imposes on Canadian firms essentially the same fiduciary duties that U.S. firms face under U.S. law. A firm's managers must act in their shareholders' interests, not in their own interests or in national or provincial interests. Their managers have strong financial incentives to maximize firm value, and no incentive to prefer national or provincial interests over the firm's interests.

There are countries (Russia is a notable example)[6] where investors apply a "corporate governance discount" because of concern about whether firms in those countries will respect shareholder interests. But investors and analysts value Canadian firms in the same way that they value U.S. firms. Analysts generally apply the same target price/earnings (P/E) ratios to U.S. and Canadian railroads.[7] And investors value the six major North American railroad companies (BN, CN, CP, CSX, NS, UP) at similar P/E ratios. Those ratios fall within a narrow range: 9 [illegible] CP); 10 (CN and NS); 11 (UP); and 12 (CSX).

More generally, I know of no evidence that Canadian firms place national or provincial interests ahead of their shareholders' interests, any more than U.S. firms do. Neither the STB nor ANPR commenters offered any such evidence. Without such evidence, I see no rational basis for the STB to worry that Canadian firms will act differently than U.S. firms in this respect.

C. Foreign Ownership Restrictions

Neither CN nor CP is subject to any restrictions on foreign ownership imposed by the Canadian government. The Commercialisation Act of 1995, which privatized CN, limits any one shareholder to owning no more than 15% of CN's shares. This rule applies equally to Canadian and non-Canadian owners, and has not deterred U.S. shareholders from acquiring over 60% of CN's common shares.

This restriction can be construed to require that CN must be the surviving parent in a merger with another class I railroad. This constraint ever so slightly affects the market for corporate control.

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[6] *See* Bernard Black, Reinier Kraakman & Anna Tarassova, ***Russian Privatization and Corporate Governance: What Went Wrong?***, 52 **Stan. L. Rev.** 1731 (2000).

[7] See, e.g., Credit Suisse First Boston, **Railroad Industry** Nov. 14, 2000) (valuing all major railroads, including CN and CP, against a common target P/E ratio).

The starting place for analysis is to recognize that – as any experienced corporate lawyer knows – in a merger between *A* and *B*, which company becomes the surviving corporate parent of the merged firm is a matter of corporate form, that generally has no substantive significance.[8] Either way, the two firms will be operated as a single merged firm. The merged firm's officers can be chosen from *A*'s or *B*'s management, and the merging firms must decide which persons will become directors of the merged firm.

The restriction on CN share ownership, combined with the Canadian Business Corporation Act requirement that a majority of a Canadian firm's directors be resident Canadians, restricts the potential composition of the merged firm's board.[9] But this is a minor matter. I am aware of no evidence that the nationality of board members affects firm performance or decisions. Even much more significant differences in board composition, such as whether a board has a majority of independent directors, do not have a significant effect on firm performance.[10]

Moreover, the STB cannot remedy any minor effect on the market for corporate control that may arise from the interplay between CN's ownership restrictions and the CBCA's board composition rule. Treating this ownership rule as a negative factor in merger review will distort the market for corporate control far more seriously than the rule itself could ever do. In my judgment, the STB should clarify that rules that limit takeovers but apply equally to domestic and foreign

[8] For discussion of planning considerations in mergers, including the accounting, tax and other factors affecting the choice of which firm survives a merger, see Ronald Gilson & Bernard Black, *The Law and Finance of Corporate Acquisitions* ch. 16 (2d ed. 1995)

[9] One can imagine more complex transaction structures, designed to comply with CN's ownership restriction, including the "stapled stock" proposal actually made by BN and CN.

[10] For reviews of the evidence on whether board composition affects firm performance, see Bernard Black & Sanjai Bhagat, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 Bus. Law. 921 (1999), Michael Weisbach & Benjamin Hermalin, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature* (working paper 2000) (available from the Social Science Research Network at http://papers.ssrn.com/paper.taf?abstract_id=233111).

shareholders, including CN's 15% ownership limit, are outside the scope of its proposed requirement.

D. National Defense Considerations

Proposed § 1180.1 l(c) requires a foreign bidder to "discuss and assess the national defense ramifications of the proposed merger." National defense considerations can play a legitimate role in regulatory review of mergers. But national defense concerns are small for rail mergers. Railroad track is the ultimate fixed-in-place asset. If a railroad doesn't fully cooperate with the government during a war or other emergency, the government can take whatever steps it needs to to obtain adequate service, including taking control of track and dispatching centers in the U.S. Carriers know this, so they have every incentive to cooperate with the government in the first place.[11]

The risk of noncooperation is especially remote as applied to CN and CP, the only foreign firms that own class I railroads. Canada has extremely close ties to the U.S., and both firms have long owned U.S. railroads and cooperated with U.S. military authorities.

D. Evidence on These Issues Can Be Presented by Merger Opponents

The STB's proposed rules for transnational mergers require merger proponents to prove a series of negatives – that foreign ownership won't affect rail safety, that a foreign firm won't act based on national or provincial considerations, that ownership restrictions won't affect merger efficiency, that foreign ownership won't affect compliance with defense needs.

These negatives can never truly be proven. For the most part, foreign bidders can only offer statements that they will behave in the same way as U.S. firms. It makes far more sense, on issues like these, for the STB to allow relevant regulatory agencies (FRA for safety issues, Department of

[11] *See* 49 U.S.C. § 11124 (giving the STB power to order cooperation, also instructing railroads to cooperate with Presidential orders); *see also* 10 U.S.C. § 2644 (President in time of war may "take possession and assume control of all or part of any system of transportation").

Defense for defense issues) and merger opponents to present evidence that a merger will have the bad effects that the STB is worried about. Merger opponents have an incentive to offer this evidence, if credible evidence exists. The merger proponents will then have to respond to the evidence presented. In all likelihood, no opponent will raise these issues, because no such credible evidence will exist. In that case, an issue has been removed from STB consideration and the merger proceeding has been simplified, in circumstances where the STB could sensibly reach only one conclusion in any event – that the hypothesized risk does not exist.

With respect to rail safety issues, the FRA can present its concerns with a proposed merger, if any. With respect to defense needs, the Department of Defense can present its concerns, if any. If the directly responsible agencies aren't concerned, there is no need for the STB to be.

VI. Conclusion

In my judgment, the STB's proposed rules interfere far too much in the market for corporate control, especially with regard to foreign bidders. The most likely effect of more intrusive STB review, across all the dimensions reviewed in this Statement, is to extend the STB's already lengthy merger review process, increase the already large cost of merger regulatory proceedings, reduce the efficiency of future rail mergers, and enrich the lawyers who represent the many parties to these proceedings.

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EMPLOYMENT

1998- :	Professor of Law, Stanford Law School courses: Business Associations Corporate Finance Corporate Acquisitions Foundations of the Regulatory State
1988-1998:	Professor of Law, Columbia Law School (Associate Professor 1988-1991)
1994-1995:	Senior Policy Advisor (resident in Moscow, Russia),Harvard Institute for International Development, Russia Legal Reform Project (advisor to Russian Government on corporate and securities law)
1987-1988:	Counsel to Commissioner Joseph A. Grundfest, Securities and Exchange Commission
1983-1987:	Private practice with Skadden, Arps, Slate, Meagher & Flom, New York, specializing in mergers and acquisitions, securities law, and corporate law
1982-1983:	Law clerk to Judge Patricia M. Wald, U.S. Court of Appeals, District of Columbia Circuit

PROFESSIONAL BOOKS

Bernard Black, Reinier Kraakman & Anna Tarassova, **A Guide to the Russian Law on Joint Stock Companies** (Kluwer Law International 1998, 1088 pp.) (Russian version published as Коммертарий Федерального Закона об Акционерных Обществах (Издательство "Лабиринт" (Labirint Press) 1999, 720 pp.) (available at http://papers.ssrn.com/paper.taf?abstract_id=246670)

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PROFESSIONAL ARTICLES

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1981: Note, *A Model Plain Language Law*, 33 **Stanford Law Review** 255-300 (1981)

1979: Robert Westervelt, James Culbertson & Bernard Black, *Discovery of the Immobility of Electron-Hole Drops in Germanium at Low Excitation*, 42 **Physical Review Letters** 267 (1979)

WORK IN PROGRESS

Corporate Law and Residual Claimants

Path-Dependent Competition for Corporate Charters: Manager Choice, Shareholder Veto (with Reinier Kraakman)

Employees as Residual Claimants: What Control Rights Should They Have?

The Essentials of Corporate Finance and Investment (with Ian Ayres) (textbook; completion expected 2002)

Board Composition and the Probability of Takeover (with Sanjai Bhagat & April Klein)

LEGISLATIVE AND REGULATORY TESTIMONY AND ADVICE

Non-U.S. Advice

- Policy advisor to the Ministry of Justice of Indonesia on company law and corporate governance reform, 2000
- Policy advisor to the Ministry of Justice of South Korea on corporate governance reform, 1999-2000
- Policy advisor to the Government of Mongolia 1996-2000 on company law and securities law; principal drafter for *Law on Companies* (1999)
- Policy advisor (1997-1999) to the Government of Vietnam for *Law on Enterprises* (1999)
- Policy advisor on Armenian law on joint stock companies, 1999-2000
- Policy advisor on draft Ukrainian law on joint stock companies, 1998-2000
- Policy advisor (1993-1997) on company law, securities law, investment fund law, and privatization of state-owned enterprises to the Russian Privatization Ministry (Госкомимущество) and the Russian Federal Securities Commission (Федеральная комиссия по ценным бумагам); advisor on *Law of the Russian Federation on Limited Liability Societies* (1998); advisor and co-drafter for *Law of the Russian Federation on Joint Stock Companies* (1996); advisor and co-drafter of *Decree of the President of the Russian Federation on Unit Investment Funds* (issued 1995)

U.S. Advice

- Advisor to Congressman Gillmor on H.R. 944 (1998) (bill to require disclosure of corporate charitable contributions)
- Written testimony on proposed amendments to the SEC's proxy rules (December 1997)
- Oral and written testimony on *Electricity Markets - 2005*, before the New York Public Service Commission, Competitive Opportunities proceedings (June 22, 1995)

• Oral and written testimony on *What's at Stake in Retail Wheeling*, before the California Public Utilities Commission (June 15, 1994)
• Written testimony on *Proxy Reform* submitted to Securities and Exchange Commission (Aug. 1992; Sept. 1991)
• Participant, Securities and Exchange Commission Roundtable on *Corporate Governance and American Economic Competitiveness* (March 19-20, 1992)
• Written testimony on *Unbundled Stock Units*, submitted to Securities and Exchange Commission (Feb. 1989)

PROFESSIONAL ACTIVITIES

• Managing director (1998-), Legal Scholarship Network (family of electronic journals that publish abstracts of working papers in different areas of law, and related online database)
• Editor (1995-), Corporate and Securities Law Abstracts and Finance and Corporate Goverance Abstracts (electronic journals of abstracts published by Legal Scholarship Network)
• Advisor (1998-2000) on company law and mutual fund law to the Ukrainian Securities Commission
• Member (1995-1998) of the Committee on the Independent States of the Former Soviet Union of the Association of the Bar of the City of New York
• Special Master, Union Carbide Corp. v. Montell N.V. (S.D.N.Y. 1998)
• Organizer, Columbia Law School Conference on Alternative Perspectives on Corporate Governance (Jan. 23, 1998)
• Member of the Board of Directors (1989-1996) and Chair of the Audit Committee of Homeland Holding Corporation and its principal subsidiary, Homeland Stores (mid-sized publicly traded corporation)
• Chair (1994-1995) and chair-elect (1993-1994) of the Business Associations section of the Association of American Law Schools
• Member (1989-1992) of the Corporation Law Committee of the Association of the Bar of the City of New York
• *Bar memberships*: New York; Washington, D.C;. U.S. Supreme Court
• *Professional associations*: American Finance Association; American Law & Economics Association; American Bar Association; New York State and District of Columbia Bars
• *Served as referee for*: Economic Inquiry; International Review of Law & Economics; Journal of Corporate Finance, Journal of Financial Economics; Journal of Law, Economics & Organization; Journal of Legal Studies; Research in Law & Economics; National Science Foundation; Sloan Foundation

EDUCATION

Stanford Law School -- J.D. 1982: Senior projects editor, *Stanford Law Review*; Johnson & Swanson Law Review Award; Sontheimer 3d-Year Honor (2d-highest 3-year GPA); Second-Year Honor (highest 2-year GPA)

University of California at Berkeley: M.A. (A.B.D. in physics) 1977

Princeton University: A.B. 1975 magna cum laude in physics

LANGUAGES

Native English
Moderate fluency in Russian

PRESENTATIONS AT WORKSHOPS AND SEMINARS

American Bar Association Annual Meeting
American Law & Econ. Ass'n Annual Meeting (5)
Ass'n of American Law Schools Annual Meeting (4)
Atlanta Finance Forum
Australian National University
Brazil Securities Commission (CVM)
Columbia Business School
Columbia Law School (2)
Columbia Univ. Department of Economics
Cornell Law School
Dartmouth Univ., Tuck School of Business
Financial Management Association Annual Meeting
Fried, Frank, Harris, Shriver & Jacobsen
George Mason Law School (2)
Georgetown Law Center
George Washington Law School
Georgia State Law School
Griffith University Law School, Australia
Harvard Business School
Harvard Law School (2)
Korean Securities Law Institute
Michigan Law School
NYU, Stern School of Business (2)
Princeton Univ., Wilson School of Public Affairs
Sao Paolo Stock Exchange, Brazil
Seoul National University, Korea, School of Business
Stanford Center for Russian and East European Studies
Stanford Law School (4)
Texas A&M College of Business
U.S. Securities & Exchange Commission
Univ. of California - Berkeley, Boalt Hall of Law
Univ. of California - Berkeley, Haas School of Business
Univ. of Colorado - Boulder, College of Business
University of Melbourne Law School, Australia
Univ. of Miami Law School
Univ of Missouri - Columbia Law School
Univ. of Pennsylvania Law School
Univ. of Rochester, Simon School of Business
Univ. of Sao Paolo, Brazil, Law Faculty
World Bank

CONFERENCES, SPEECHES, AND COMMENTS

2000: Participant, University of Pennsylvania Law School Roundtable on Corporate Law (May 12, 2000)

1999: Presentation of *Russian Privatization and Corporate Governance: What Went Wrong?*, OECD Conference on Corporate Governance in Russia (Moscow, Russia, May 31, 1999); International Monetary Fund Workshop on Comparative Corporate Governance in Developing and Transition Economies (June 24, 1999); Davidson Institute at Univ. of Michigan Conference on Corporate Governance Lessons from Transition Economy Reforms (Sept. 24-25, 1999)

Participant, Conference on *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Paris, France, July 15-16, 1999)

Workshop leader, International Monetary Fund Workshop on Comparative Corporate Governance in Developing and Transition Economies (June 24, 1999)

Presentation of *The Legal and Institutioal Prerequisites for Strong Securities Markets*, OECD Conference on Corporate Governance in Asia: A Comparative Perspective (Seoul Korea, Mar. 3-5, 1999), International

Monetary Fund Workshop on Comparative Corporate Governance in Developing and Transition Economies (June 24, 1999); UCLA School of Law First Annual Conference on Corporate Governance (Sept. 17, 1999)

Participant, Workshop on Innovation in Business Law Education, American Bar Association Section of Business Law annual meeting (Apr. 17, 1999)

Presentation of *Board Independence and Long-Term Firm Performance*, Directors' College, Stanford Law School (Mar. 23, 1999); Federalist Society Conference on Corporate Governance (NY, Sept. 18, 1998) (remarks published in **Bank and Corporate Governance Reporter** (1999)); 1996)

Participant, Conference on Armenian Company Law, Washington DC (Jan. 11-15, 1999) (conference with drafters of the Armenian company law to discuss concepts of company law)

1998: Participant, Conference on Ukrainian Company Law, Kiev Ukraine (Oct. 26-30, 1998) (seminar for legislators and government officials on draft company law)

Participant, Corporate Law Bridge Group conference (June 26-27, 1998)

Presentation of *Path-Dependent Competition for Corporate Charters: Manager Choice, Shareholder Veto*, Comparative Law Workshop on the Regulatory State and Corporate Governance, Goethe Universitat, Frankfurt Germany (May 9, 1998)

Invited speaker on comparative and international aspects of corporate law scholarship, Association of American Law Schools, *Workshop on Business Associations* (May 1-2, 1998)

Invited speaker, U.S. Securities and Exchange Commission, *International Institute for Securities Market Development* (Apr. 30, 1998)

Presented paper, *Preventing Manager/Investor Disputes from Arising*, Conference on *The Changing Landscape of Investment in Russia*, Moscow, Russia (Apr. 23, 1998)

Invited speaker, *Seminar on the Draft Company Law*, Hanoi, Vietnam (Mar. 10-17, 1998) (seminar for legislators and government officials on the draft company law)

Presentation of *The Building Blocks of Corporate Governance*, Columbia Law School Conference on Alternative Perspectives on Corporate Governance (Jan. 23, 1998)

Invited speaker, *Seminar on the Law on Joint Stock Companies*, Ulanbaatar, Mongolia, Jan. 6, 1998 (seminar for legislators and government officials on the Law on Joint Stock Companies, for which I was the principal drafter)

1997: Participant in *Symposium, Check-the-Box and Beyond: The Future of Limited Liability Entities* (Larry Ribstein & Mark Sargent eds.), 52 **Business Lawyer** 605-652 (1997)

Presentations of *Board Composition and Firm Performance: The Uneasy Case for Majority Independent Boards*, Max-Planck Institute Conference on Comparative Corporate Governance (Hamburg, Germany, May 15-17, 1997); NYU Salomon Center Conference on The Power and Influence of Pension and Mutual Funds (Feb. 21, 1997)

Lecturer, Open Society Institute workshop for Russian law teachers, on *the Russian Law on Joint Stock Companies* (Moscow, Russia, Nov. 11-15, 1997)

Presentation of *Information Asymmetry, the Internet, and Securities Offerings*, Lewis & Clark Law Forum, Financing Innovation: The Future of Capital Formation for Small and Emerging Businesses (Sept. 26, 1997)

Address on *The Struggle for Control of Russia's Securities Markets*, Harriman Institute Conference on Russian Securities on the American and Russian Capital Markets (New York, June 10, 1997)

Invited Speaker for Plenary Session on *Stranded Costs*, National Conference of State Legislatures Conference, The Electric Industry in the Balance (New York, May 29-30, 1997)

Participant, USAID-sponsored conference with Vietnamese officials on draft *Law of Vietnam on Partnerships and Companies* (New York, Aug. 26-30, 1997)

Lecturer, World Bank Central European University workshop on *Corporate Governance in Eastern Europe and Russia* (Budapest, Hungary, May 12-16, 1997)

Invited Speaker, World Bank Conference on *Legal Reform and Economic Development* (Apr. 14, 1997)

1996: *Corporate Law for Emerging Markets: The Case of Russia*, in **American Society of International Law, Proceedings of 90th Annual Meeting: Are International Institutions Doing Their Job?** 226-231 (1996)

Presentation of *Corporate Law and Residual Claimants*, Columbia Law School Conference on Employees and Corporate Governance (Nov. 22 & May 15, 1996)

Address on *The Path-Dependent Evolution of Corporate Law*, George Mason Law School Conference on Strong Managers, Weak Owners (May 4, 1996)

1995: Bernard Black, *Legal Reform in Russia*, **Columbia Law School Report** 68 (Fall 1995) (short article for alumni magazine)

Presentations of *Corporate Law from Scratch*, World Bank Conference on Corporate Governance in Central Europe and Russia (Apr. 22, 1994; Sept 30, 1994; Dec. 16, 1994)

Address on *Investment Fund Law for Emerging Economies*, OECD Conference on Investment Funds in Ukraine (Paris, France, June 1-2, 1995)

1994: *Comment: The Industrial Organization of Market-Making*, on Peter Reiss & Ingrid Werner, *Transacting Costs in Multiple Dealer Markets: Evidence from the London Stock Exchange*, in Andrew Lo, ed., **The Industrial Organization and Regulation of the Securities Industry** 171-174 (1995)

Address on *The Essentials of Corporate Governance in Privatizing Economies*, World Bank Conference on Creating Capital Markets in Central and Eastern Europe (Prague, Czech Republic, Nov. 17, 1994)

1993: Presentations of *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*: Whittemore Conference on The International Capital Acquisition Process (May 21, 1993); Columbia Law School Conference on Relational Investing (May 6, 1993)

1992: Participant, *Roundtable on Management Incentive Compensation and Shareholder Value*, **Continental Bank Journal of Applied Corporate Finance** 110-130 (Summer 1992)

Comment, *Event Studies in a World with Signalling and Partial Anticipation*, on Kleidon & Scott, *The Replacement of Corporate Chief Executive Officers and the Performance of the Board*, American Law & Economics Association (May 16, 1992)

1991: Contributor to *Catch 22: The Retired CEO as Company Director* (Institutional Shareholder Services Special Report, July 15, 1991)

Contributor to Roundtable discussion on *Institutional Investors and Corporate Governance*, published in **Directors and Boards** 9 (Spring 1991)

Presentation of *Agents Watching Agents*: Columbia Law School Conference on The Future of Corporate Governance (May 11, 1991)

Address on on *Environmental Sanctions: When Does Deterrence Become Overkill?*; Columbia Journal of Environmental Law Symposium on Crimes Against the Environment (Mar. 8, 1991)

Address on *Taking Long-Term Investing Seriously*; Institutional Shareholder Services Conference for the Proxy Professional (Feb. 22, 1991)

1990: Conference presentation on *Hazardous Waste Cleanup Incentives in Corporate Acquisitions*; Columbia Business Law Review Symposium on Environmental Concerns in Business Transactions (Feb. 9, 1990)

1989: Address on *The Long Term Profitability of Leveraged Buyouts*; Lowe Institute Conference on the Leveraging of Corporate America, Los Angeles (Apr. 11, 1989)

1988: Presentation of *Is Corporate Law Trivial?*, Columbia Law School Conference on Contractual Freedom and Corporate Law (Dec. 9, 1988)

Address on *Shareholder Gains from Takeovers*, Rutgers Conference on Corporate Takeovers, Restructuring, and the Market for Corporate Control (May 24, 1988)

Address on *Regulatory Reform after the Market Crash: The Case for Flow Restrictors*; USC-UCLA Conference on The Crash: Causes and Cures? (Feb. 13, 1988)

PERSONAL DATA

Born 1953 in Brooklyn, New York
Married - wife Brenda Hoy

Children:	David (21)	Samuel (15)	Rebekah (6)
	Benjamin (20)	Sarah (10)	

VERIFICATION

I, Bernard S. Black, verify under penalty of perjury that the foregoing statement is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Bernard S. Black

Bernard S. Black

Executed this 17th day of November, 2000.

CERTIFICATE OF SERVICE

I certify that I have this 17th day of November, 2000, served copies of the foregoing Comments of Canadian National Railway Company (including the attached Statement of Professor Bernard S. Black) upon all known parties of record in this proceeding by first-class mail or a more expeditious method of delivery.

Sülay Öztürk